MIDNIGHT
Oil Exploration Ltd.

2007 Year End Report

Exploring for Energy with Experience and Expertise.

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CORPORATE PROFILE

Midnight Oil Exploration Ltd. ("MOX") is a top quality junior exploration and production company that focuses on selected multi-zone, high-potential areas of the Western Canadian Sedimentary Basin. Midnight employs a proven formula combining a high-end technical team with experience, expertise, and innovative business execution skills that provide a competitive edge in our areas of operation. Its investment strategy is driven by a risk-balanced portfolio of high-potential exploration and development prospects and strategic acquisitions.

ANNUAL GENERAL MEETING ANNOUNCEMENT

Midnight's Annual General Meeting will be held at: The Sun Life Conference Centre, Plus 15 Level, Sun Life Plaza, 140 – 4th Avenue SW, Calgary, Alberta, Wednesday, May 14, 2008 at 10:00 AM MDT.

All Shareholders are invited to attend and for those unable to do so, we encourage you to sign and return the form of proxy mailed to ensure representation at the meeting.

ABBREVIATIONS

/d	per day
bbl(s)	barrel(s)
mbbls	thousand barrels
mcf	thousand cubic feet
mmcf	million cubic feet
bcf	billion cubic feet
boe	barrels of oil equivalent
mboe	thousand barrels of oil equivalent
mmbtu	millions of British thermal units
ARTC	Alberta Royalty Tax Credit
WTI	West Texas Intermediate
NGLs	natural gas liquids
Cdn	Canadian
US	United Sates

PRESIDENT'S MESSAGE

For 2007 Midnight had a very clear strategy: watch our capital and focus on high value oil opportunities. We set the strategy early and stayed the course throughout the year. We used our strong cash flow to pursue an oil focused capital program in Red Earth that included development and exploration drilling and the commencement of a waterflood. We also high-graded our gas opportunities making selected investments in the Peace River Arch and West Central Alberta. As a result, we were able to maintain a solid production base and strong balance sheet while working on growing our high potential prospect inventory.

As is often the case in our industry, 2007 was another dynamic year for junior exploration companies. The year started with an industry wide concern of the overall economics for our business amid the spectre of high service costs and soft natural gas prices. This situation challenged the economic formula in a predominately natural gas basin by both reducing our cash flow and restricting our access to capital. That said, at Midnight we were well positioned with a solid balance sheet, a light oil weighted cash flow stream and a large prospect inventory of both light oil development and exploration and natural gas development opportunities.

Under these circumstances, we decided to pace our capital spending and pursue our more highly valued light sweet oil opportunities in Red Earth. Generally the costs of an oil weighted program are higher compared to gas but the netbacks are also much higher. In the case of Midnight we have enjoyed field operating netbacks of $37 to $56 per barrel from our light oil versus $21 to $33 per boe for our natural gas. In addition, oil weighted programs tend to be longer term investments in order to get full reserve value from third party evaluators. We have commenced and made significant investments for the long term value of our oil holdings and additional reserves will be credited in the future. In consideration of the distinct character of our investment strategy, our results are best evaluated when compared to our corporate three year average finding and development costs of $30.56 per boe which equates to a recycle ratio of 1.5x on our oil projects. This perspective most accurately presents the success of our oil program and is substantiated by our increased reserve value despite a drop in the price forecast used for natural gas. Thus what we sacrificed in higher finding and development costs have been more than made back in higher and stronger netbacks and higher and stronger reserve values. In an environment where many companies suffered weak cash flow we have been able to maintain solid cash flow and a solid balance sheet.

Under our disciplined capital program we were not as active drilling new reserve targets as we reduced our 2007 well count to 21 gross (6.9 net) from 33 gross (17.2 net) wells in 2006. Instead we committed more funds to facilities and road construction. We spent about 50% of our capital at Red Earth in drilling, pipelining, road construction and commenced a significant waterflood. In addition to drilling five gross (4.0 net) total wells consisting of three gross (2.5 net) oil wells, one gross (1.0 net) gas well and one (0.5 net) dry hole, we invested in the long term commitment to this property. This included building water handling facilities and initiating a waterflood for enhanced recovery. Although the initial investment was significant for the size of our company, we will receive long term benefits as we grow the reserves resulting from the waterflood and reduce operating costs. On the natural gas side, we directed our activities towards the Peace River Arch, drilling four gross (2.2 net) wells. In addition, we continued our participation in a gas development program with partners in our West Central area participating in 12 gross (0.6 net) gas wells.

As a result, we were able to maintain our production levels and our cash flow over the year. In the fourth quarter of 2007, our oil and liquids production increased 18% and 10% respectively over the same period in 2006, and oil and liquids pricing also increased by 37% and 32% respectively over the fourth quarter in 2006. Indeed our gas production and revenues declined modestly, but we definitely benefited from our strategy. The strength in oil more than offset the decrease in natural gas production and pricing relative to the fourth quarter of 2006 resulting in an overall increase in sales of 15% and cash flow of 2% in Q4 2007 compared to Q4 2006.

Midnight's production for 2007 averaged 2,098 boe/d and was essentially equivalent to the average production for 2006. Midnight's increase in average daily production of oil and natural gas liquids in 2007 of 26% was offset by a corresponding decrease in natural gas production on a barrel of oil equivalent basis.

In Q4 2007, Midnight's capital expenditures were primarily focused on Red Earth with our exploratory drilling and commencement of construction of an enhanced oil recovery waterflood. In east Red Earth, we drilled 2 exploratory wells (100% interest) with mixed success. We continue to evaluate the results of this program and have started the construction of our pipeline to allow us to produce our highly successful 5-18-87-6w5 discovery well. At the beginning of 2008, Midnight operated the drilling of another oil well discovery in central Red Earth. This well is part of our development and exploitation of the B pool where we are implementing our waterflood. This was an excellent well and validated our reservoir model. Currently, we are restricted in our production to 120 bbls/d, but initial productivity indicates the well is capable of over 250 bbls/d. Based on our waterflood investment, including the conversion of one well to water injection, we have applied to the ERCB for removal of allowable restriction in order to produce the well under Good Production Practices at the unrestricted and capable rate. This success opens up a number of additional locations which Midnight, as operator, will be pursuing later in 2008.

In Q4 2007 in the Red Rock area of the Deep Basin, Midnight completed the pipelining and tie-in of a sweet gas well that we drilled last winter. This multi-zone discovery well has been placed on stream in the first quarter at a restricted rate, averaging 1,000 mcf per day (net 500 mcf/d). Access to the area is seasonally limited but with the new gas pipeline now in place, we have identified additional locations to pursue on our lands (MOX 50-100%).

Also in Q1 2008, in the Elmworth area, we are participating (Midnight 50%) in a horizontal well being drilled into the Cadomin formation. This is a very exciting high potential play in a tight gas sand reservoir. The potential exists for a number of high productivity, large reserve wells to be drilled. Offsetting Cadomin horizontals have produced with initial rates of over 5 mmcf/d. Midnight has a great deal of experience and technical expertise in these tight gas reservoirs. We continue to add to our land and prospect inventory in this general area and have entered into two farm-in arrangements to expand our land holdings.

Midnight's increased investment in the Red Rock area and in Elmworth is a key part of Midnight's strategy to further increase our exposure to sweet natural gas prospects in the high potential Deep Basin. This strategy is set in place in anticipation of stronger natural gas prices, which are currently rising, and also with a longer term view that we will enjoy much higher North America gas prices, likely to settle over $10.00 per mcf. That said we have been served well over the past year with our balanced portfolio of light oil and sweet gas opportunities. Notwithstanding our higher finding costs we have consistently been top decile in the industry for our revenue and netbacks per boe.

In the Pembina area, Midnight has a 37.5% working interest in a high impact exploratory prospect targeting the highly prolific sour Nisku oil reservoir. Our partner has been highly successful with drilling similar prospects in the area. Our partner is the operator and received a drilling licence in Q3 2007 to drill our joint well. However, continued delays in obtaining final approvals from the regulating agency have further delayed the anticipated spud date of this well until later in 2008. This is a high impact exploratory oil prospect that requires significant planning and involves long lead times, but if successful, would add significantly to our light oil production base.

The talent and expertise of our team and the flexibility of our opportunity base are the core strengths of Midnight. Yet however proficient our team of professionals may be, the Canadian federal and Alberta provincial governments continue to mistreat our industry. With the strength of commodities the natural assumption would be that we are enjoying the best of times. However, the Canadian oil industry has not benefited to a degree proportionate to the increase in commodities. In fact, in 2007 while broader Canadian and U.S. markets matched each other in performance, the NYSE Energy index rose 27% while TSX Capped Energy index increased only 8%. Capital is liquid and flows to the best returns and best opportunities and the Canadian governments have added political risk to the

assessment of risks and returns. The actions of two levels of our government exasperate this market response. This has also negatively impacted our share price and negatively affected our ability to economically access and deploy capital. Reasonably priced access to capital for small and medium sized conventional energy companies is integral for our success and growth. The New Royalty Framework announced by the Alberta government on October 25, 2007 (NRF) is scheduled to take effect January 1, 2009. Midnight engaged GLJ Petroleum Consultants ("GLJ") to prepare a forward looking analysis of Midnight's estimated 2007 reserves applying the expected NRF effective January 1, 2009. That analysis indicated that the net present value of reserves discounted at 10% decreased by approximately 10% to 13% (using forecasted prices and costs). The value of our existing reserves have been negatively impacted as has the economics of the development of our light-oil property in Red Earth. Notwithstanding the actions of the governments, we have a strong and vibrant company with a large and high potential prospect inventory and are confident we will reward our shareholders for their patience in this environment.

In response to our reduced share price, and in the face of the market's response to the government's initiatives on October 16, 2007 to increase Crown royalties, Midnight announced a normal course issuer bid. During the fourth quarter of 2007, the Company purchased and cancelled 232,700 common shares at an average market price of $1.13 per share reducing the total number of common shares outstanding at year end to 47,595,129. To date in Q1, 2008, the Company purchased and cancelled an additional 172,500 common shares at an average market price of $1.10 per share.

While the conventional oil and gas sector continues to be challenged by high costs, penalizing government initiatives and a lack of access to capital markets, Midnight continues to deliver solid results. We are focused on building our prospect inventory for both light oil and sweet natural gas and bringing on stream those reserves that will add the most value to our shareholders. We have assembled and continue to build a large and highly prospective sweet gas prospect land holding in our Peace River Arch area and selectively participate in a highly successful gas development program with our partners in West Central Alberta. We have a strong balance sheet and a committed staff and we are optimistic about the future of the conventional oil and gas industry in Canada.

Midnight is a top quality junior exploration company with a high end technical team with a proven track record. Our oil weighted production base, a strong balance sheet and a high quality prospect inventory leaves Midnight extremely well positioned for this stage of the cycle. We are moving Midnight towards a larger focus on natural gas and look forward to taking advantage of the opportunities we have created and the opportunities that this stage will afford us.

Shareholders are invited to attend Midnight's 2008 Annual Meeting of Shareholders scheduled for 10:00 AM, Wednesday May 14, 2008 at the Sun Life Conference Centre, located at 140 4th Avenue S.W., Calgary, Alberta.

Signed "Fred Woods"

President and Chief Executive Officer
March 18, 2008

RESERVES

The reserve data set forth below is based on an independent reserves evaluation conducted by GLJ Petroleum Consultants Ltd. ("GLJ") effective December 31, 2007 ("GLJ Report") and prepared in accordance with the definitions set out under National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities ("NI 51-101"). Midnight has a reserves committee comprised of a majority of independent board members who review the qualifications and appointment of the independent reserve evaluators. The committee also reviews the process for providing information to the evaluators and meets with the independent evaluators to discuss the procedures used in the independent report, to review the Company's major properties and to identify and discuss any areas of risk. The GLJ Report was reviewed by the reserves committee of Midnight and was approved by the Company's Board of Directors on March 18, 2008.

The reserve highlights are:

- Company interest proved reserves at December 31, 2007 were 4.23 million boe.
- Company interest proved plus probable reserves at December 31, 2007 were 6.32 million boe.
- Additions to proved reserves replaced 2007 average production by 106%.
- The net present value (before tax discounted at 10%) of total proved plus probable reserves increased 2% to $120.7 million.

Reserves Advisory

- Reserves included herein are stated on a company interest basis where reserves include royalty interest (operating and non-operating) and before royalty burdens.
- Natural gas is converted to barrels of oil equivalent ("boe") at a ratio of six thousand cubic feet to one barrel of oil.
- Boe's may be misleading, particularly if used in isolation. In accordance with NI 51-101, a boe conversion ratio for natural gas of 6 Mcf: 1 bbl has been used which is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.
- Tables may not add due to rounding.

FORECAST PRICES AND COSTS

Summary of Oil and Gas Reserves – *Company Interest Reserves*

Reserves Category	Light Oil (Mbbls)	Natural Gas (MMcf)	Natural gas Liquids (Mbbls)	2007 Total (Mboe)	2006 Total (Mboe)
Proved					
Developed Producing	1,034	11,282	265	3,180	3,483
Developed Non-Producing	145	2,289	20	546	424
Undeveloped	318	1,064	6	501	272
Total Proved	1,497	14,635	291	4,227	4,180
Probable	1,198	4,912	80	2,096	2,306
Total Proved Plus Probable	2,695	19,547	371	6,323	6,486

NET PRESENT VALUE ("NPV") SUMMARY 2007

Midnight's crude oil, natural gas and natural gas liquids reserves were evaluated using GLJ's product price forecasts effective January 1, 2008 prior to provision for income taxes, interest, debt service charges and general and administrative expenses. It should not be assumed that the discounted future net production revenues estimated by GLJ represent the fair market value of the reserves.

Net Present Value of Reserves, before income taxes

December 31, 2007 (000's)	**0%**	**5%**	**8%**	**10%**	**12%**	**15%**
Proved Reserves						
Developed Producing	109,729	89,297	80,835	76,195	72,164	67,014
Developed Non-Producing	13,905	10,660	9,275	8,511	7,847	6,999
Undeveloped	13,132	9,123	7,418	6,482	5,671	4,646
Total Proved	136,767	109,080	97,528	91,188	85,682	78,660
Probable	75,869	44,041	34,230	29,511	25,751	21,369
Proved plus Probable	212,636	153,121	131,758	120,698	111,433	100,029

At December 31, 2007 using a 10% discount factor, the proved producing reserves make up 63% of the proved plus probable value while total proved reserves account for 76% of the proved plus probable value. Midnight's proved non-producing and undeveloped reserves account for 1 million boe of the total proved reserves booked but account for only 16.5% of the value of our proved reserves. The future capital associated with these proved reserves included in the 2007 GLJ Report is approximately $12.3 million and have been subtracted from the future value of the proved reserves.

The GLJ's price forecast utilized in the forecast evaluation is summarized below.

GLJ January 1, 2008 Price Forecast

Year	**West Texas Intermediate Crude Oil**	**Edmonton Light Crude Oil**	**Natural Gas at AECO**	**Foreign Exchange**
	($US/bbl)	($Cdn/bbl)	($Cdn/mmbtu)	($US/$Cdn)
2008	92.00	91.10	6.75	1.00
2009	88.00	87.10	7.55	1.00
2010	84.00	83.10	7.60	1.00
2011	82.00	81.10	7.60	1.00
2012	82.00	81.10	7.60	1.00
2013	82.00	81.10	7.60	1.00
2014	82.00	81.10	7.80	1.00
2015	82.00	81.10	7.97	1.00
2016	82.02	81.12	8.14	1.00
2017	83.66	82.76	8.31	1.00
2018	85.33	84.42	8.48	1.00
2019+	+2.0%/yr	+2.0%/yr	+2.0%/yr	1.00

RESERVE RECONCILIATION

Reconciliation of Changes in Company Reserves by Principal Product Type Forecast Prices and Costs

Factors	**Crude Oil & NGLs**		**Natural Gas**		**Total**	
	Proved (Mbbls)	**Proved + Probable** (Mbbls)	**Proved** (MMcf)	**Proved + Probable** (MMcf)	**Proved** (Mboe)	**Proved + Probable** (Mboe)
December 31, 2006	1,773	3,066	14,438	20,522	4,180	6,486
Extensions & improved recovery	211	344	3,253	4,473	753	1,089
Technical Revisions	202	54	(848)	(3,240)	61	(486)
Production	(398)	(398)	(2,208)	(2,208)	(766)	(766)
December 31, 2007	**1,788**	**3,066**	**14,635**	**19,547**	**4,227**	**6,323**

FINDING, DEVELOPMENT AND ACQUISITION ("FD&A") COSTS

Midnight's capital expenditures on exploration and development totalled $27.3 million in 2007 with no acquisitions in the current year. On a proven reserve basis, the Company's FD&A cost for 2007 excluding future capital was $33.52 per barrel of oil equivalent, down 12% from 2006. The calculation of FD&A cost for proved reserves including future capital of $12.3 million included in the 2007 GLJ Report, and deducting $6.2 million of future capital which was included in the 2006 GLJ Report results in a FD&A cost of $41.04 per boe. On a proven plus probable reserve basis, the Company's FD&A cost for 2007 was $45.25 per boe excluding future capital. The calculation of FD&A cost for proved plus probable reserves including future capital of $24.7 million included in the 2007 GLJ Report, and deducting $19.3 million of future capital which was included in the 2006 GLJ Report results in a FD&A cost of $54.20 per boe.

NI 51-101 requires that FD&A costs be calculated including changes in Future Development Capital ("FDC"). Changes in forecast FDC occur annually as a result of development activities, acquisition and disposition activities and capital cost estimates that reflect the independent evaluator's best estimate of what it will cost to bring the proved undeveloped and probable reserves on production. The current high level of activity has resulted in increased capital costs throughout the industry that are now reflected in the estimates of future development costs effective December 31, 2007.

FD&A Costs – Company Interest Reserves	**2007**		**2006**	
	Proved	**Proved plus Probable**	**Proved**	**Proved plus Probable**
Capital costs ($000's)				
Exploration and Development	27,283	27,283	61,733	61,733
Acquisitions	n/a	n/a	n/a	n/a
	27,283	27,283	61,733	61,733
Change in Exploration and Development FDC	6,124	5,398	(3,715)	906
	33,407	32,681	58,018	62,639
Reserve additions[1](Mboe)				
Exploration and Development	814	603	1,617	2,308
Finding, development and acquisition costs ($/boe)				
Exploration and Development Capital including change in FDC	**$ 41.04**	**$ 54.20**	$ 35.88	$ 27.14
Exploration and Development Capital excluding change in FDC	**$ 33.52**	**$ 45.25**	$ 38.18	$ 26.75

Notes:

(1) Reserve additions include technical revisions.

(2) The aggregate of the exploration and development costs incurred in the year and the change during the year in estimated future development costs generally will not reflect total finding and development costs related to reserves.

FD&A ($/boe) Exploration and Development Capital including change in FDC	**2005**	**2006**	**2007**	**3 Year**
Proved	27.72	35.88	41.04	34.36
Proved plus Probable	26.09	27.14	54.20	30.56

Midnight's 2007 netbacks were $44.64/boe for oil, $26.33/boe for NGLs and $26.34/boe for natural gas combining for a total netback of $34.49/boe. With 2007 netback of $34.49/boe, the recycle ratio for the company was 1.0x for proved and 1.1x for proved plus probable.

NET ASSET VALUE

At December 31, 2007, Midnight had an estimated net asset value of $2.53 per basic share discounting the present value of proved and probable reserves at 10% before tax including a provision for undeveloped lands, seismic and excluding net debt. The present value of petroleum and natural gas reserves were determined by GLJ in their year end evaluation. Undeveloped land at December 31, 2007 was internally valued at an average price of $157 per acre based on a previous Seaton and Jordan report, and undeveloped seismic and other assets were internally evaluated based on the lower of cost or market.

Net Asset Value- Forecast Pricing and Costs at December 31, 2007	**Mboe**	**$/Boe**	**PV ($M)**	**$/Share**
Proved Reserves Value at 10% BIT	4,227	21.57	91,188	$ 1.92
Probable Reserves Value at 10% BIT	2,096	14.08	29,510	0.62
Proved plus Probable Reserves Value at 10% BIT	6,323	19.09	120,698	$ 2.54
	(000's)	**$/acre**		
Undeveloped Land	148 acres	157	23,211	0.49
Seismic and Other Assets			4,894	0.10
Net Debt			(28,374)	(0.60)
Total Net Assets			**$ 120,429**	
Basic Shares Outstanding	47,595			
NET ASSET VALUE				**$ 2.53**

At December 31, 2007 there are no material differences between basic and fully diluted net asset value calculations.

Land Holdings

The following table sets out Midnight's land holdings as at December 31, 2007.

	Developed		**Undeveloped**		**Total**	
	Gross(1)	Net(2)	Gross(1)	Net(2)	Gross(1)	Net(2)
			(acres)			
Alberta	188,100	31,900	260,400	124,300	448,500	156,200
British Columbia	1,400	500	32,700	23,400	34,100	23,900
Total	189,500	32,400	293,100	147,700	482,600	180,100

Notes:

(1) "Gross" refers to the total acres in which Midnight has an interest.

(2) "Net" refers to the total acres in which Midnight has an interest, multiplied by the percentage working interest therein owned by Midnight.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis ("MD&A") as provided by the management of Midnight should be read in conjunction with the audited Consolidated Financial Statements and accompanying notes for the years ended December 31, 2007 and 2006. Additional information relating to Midnight, including a detailed reserve analysis, will be included in our Annual Information Form, which may be found on SEDAR at www.sedar.com.

Basis of Presentation – The financial data presented below has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). The reporting and the measurement currency is the Canadian dollar. For the purpose of calculating unit costs, natural gas is converted to a barrel equivalent ("boe") using six thousand cubic feet of natural gas equal to one barrel of oil unless otherwise stated. The following MD&A compares the results of the year ended December 31, 2007 ("2007") to the year ended December 31, 2006 ("2006") and the results of the three months ended December 31, 2007 ("Q4 2007") to the three months ended December 31, 2006 ("Q4 2006") and the three months ended September 30, 2007 ("Q3 2007").

Non-GAAP Measurements - Within the Management's Discussion and Analysis references are made to terms commonly used in the oil and gas industry. Funds from operations, funds from operations per share and netbacks are not defined by GAAP in Canada and are referred to as non-GAAP measures. Funds from operations per share is calculated based on the weighted average number of common shares outstanding consistent with the calculation of net income per share. Netbacks equal total revenue less royalties and operating and transportation expenses calculated on a per boe basis. Management utilizes these measures to analyze operating performance and leverage. Funds from operations is not intended to represent operating profit for the period nor should it be viewed as an alternative to operating profit, net income, cash flow from operations or other measures of financial performance calculated in accordance with Canadian GAAP. Funds from operations is commonly referred to as cash flow by research analysts and is used to value and compare oil and gas companies and is frequently included in published research when providing investment recommendations. Total boes are calculated by multiplying the daily production by the number of days in the period.

The following table reconciles cash flow from operations to funds from operations which is used in the MD&A:

($000s)	**Q4 2007**	Q4 2006	Q3 2007	**2007**	2006
Cash flow from operations	**6,026**	8,289	6,510	**21,413**	25,260
Abandonment expenditures	**17**	235	12	**167**	297
Changes in non-cash working capital	**(1,145)**	(3,734)	(1,602)	**(206)**	(3,558)
Funds from operations	**4,898**	4,790	4,920	**21,374**	21,999

Forward Looking Statements - Certain statements contained within the Management's Discussion and Analysis, and in certain documents incorporated by reference into this document, constitute forward looking statements. These statements relate to future events or our future performance. All statements other than statements of historical fact may be forward looking statements. Forward looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward looking statements. We believe the expectations reflected in those forward looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in, or incorporated by reference into, this MD&A should not be unduly relied upon. These statements speak only as of the date of this MD&A or as of the date specified in the documents incorporated by reference into this Management's Discussion and Analysis, as the case may be.

In particular, this Management's Discussion and Analysis, and the documents incorporated by reference, contain forward-looking statements pertaining to the following:

- *the performance characteristics of our oil and natural gas properties;*
- *oil and natural gas production levels;*
- *the size of the oil and natural gas reserves;*
- *projections of market prices and costs;*
- *supply and demand for oil and natural gas;*
- *expectations regarding the ability to raise capital and to continually add to reserves through acquisitions and development;*
- *treatment under governmental regulatory regimes and tax laws; and*
- *capital expenditures programs.*

The actual results could differ materially from those anticipated in these forward looking statements as a result of the risk factors set forth below and elsewhere in this Management's Discussion and Analysis:

- *volatility in market prices for oil and natural gas;*
- *liabilities inherent in oil and natural gas operations;*
- *uncertainties associated with estimating oil and natural gas reserves;*
- *competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel;*
- *incorrect assessments of the value of acquisitions;*
- *geological, technical, drilling and processing problems; and*
- *changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry.*

Statements relating to "reserves" or "resources" are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the resources and reserves described can be profitably produced in the future. Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward looking statements contained in this MD&A and the documents incorporated by reference herein are expressly qualified by this cautionary statement. We do not undertake any obligation to publicly update or revise any forward-looking statements except as required by securities law.

This Management's Discussion and Analysis is dated as of March 18, 2008.

Selected Annual & Quarterly Information

Set out below is selected annual information for Midnight for the last three years:

Financial (000's, except for per share amounts)	**2007**	**2006**	**2005**
Petroleum and natural gas sales	**$ 43,153**	$ 39,688	$ 22,989
Funds from operations	**21,374**	21,999	12,062
Per share – Basic	**0.45**	0.53	0.44
– Diluted	**0.45**	0.53	0.43
Net income (loss)	**$ (1,219)**	$ 45	$ 1,669
Per share – Basic	**(0.03)**	0.00	0.06
– Diluted	**(0.03)**	0.00	0.06
Petroleum and natural gas additions	**$ 27,330**	$ 61,752	$ 76,507
Net debt	**28,374**	21,974	16,730
Total assets	**164,681**	152,833	111,171
Shares outstanding			
Basic	**47,595**	47,828	38,328
Diluted	**52,600**	53,548	41,511

Operations	2007	2006	2005
Average daily production			
Natural gas (mcf/d)	**6,050**	7,755	4,666
Oil & NGLs (bbls/d)	**1,090**	866	326
Combined (boe/d)	**2,098**	2,158	1,104
Netback ($/boe)	**$ 34.48**	$ 31.79	$ 33.07

Set out below is selected information by quarter for Midnight for the last eight quarters:

Financial (000's, except for per share amounts)	2007 Q4	2007 Q3	2007 Q2	2007 Q1	2006 Q4	2006 Q3	2006 Q2	2006 Q1
Petroleum and natural gas sales	**$ 10,811**	$ 10,439	$ 11,009	$ 10,894	$ 9,410	$ 10,099	$ 10,988	$ 9,191
Funds from operations	**4,898**	4,920	6,069	5,487	4,790	5,479	6,533	5,197
Per share – Basic	**0.10**	0.10	0.13	0.11	0.11	0.13	0.16	0.14
– Diluted	**0.10**	0.10	0.13	0.11	0.11	0.13	0.16	0.13
Net income (loss)	**$ (19)**	$ (827)	$ 51	$ (424)	$ (565)	$ 320	$ 82	$ 208
Per share – Basic	**(0.00)**	(0.02)	0.00	(0.01)	(0.01)	0.01	0.00	0.01
– Diluted	**(0.00)**	(0.02)	0.00	(0.01)	(0.01)	0.01	0.00	0.01
Petroleum and natural gas additions	**$ 8,092**	$ 3,217	$ 3,439	$ 12,582	$ 8,652	$ 13,670	$ 9,945	$ 29,485
Net debt	**28,374**	24,886	26,577	29,170	21,974	33,579	25,297	41,028
Total assets	**164,681**	160,573	161,537	159,594	152,833	147,677	138,842	134,452
Shares outstanding								
Basic	**47,595**	47,828	47,828	47,828	47,828	42,328	42,328	38,328
Diluted	**52,600**	52,953	53,168	53,001	53,548	45,914	45,903	41,495
Operations								
Average daily production								
Natural gas (mcf/d)	**5,573**	5,981	5,769	6,891	7,352	7,637	10,091	5,926
Oil & NGLs (bbls/d)	**1,036**	1,050	1,185	1,090	890	841	830	901
Combined (boe/d)	**1,965**	2,047	2,146	2,239	2,115	2,114	2,512	1,889
Netback ($/boe)	**$ 34.39**	$ 33.77	$ 37.37	$ 32.45	$ 29.08	$ 33.15	$ 31.68	$ 33.54

Midnight has a balanced portfolio of light oil and sweet gas production that have delivered solid production and funds from operations. Growth in petroleum and natural gas sales and funds from operations are derived by the combination of increased oil production and strong commodity prices. Midnight commenced operations in December 2004 with production averaging 723 boe/d for the month. During 2005 production grew from a combination of drilling 42 gross (10.8 net) wells and on November 29, 2005, Midnight acquired the Red Earth property increasing our production for Q4 2005 by 303 boe/d. In 2006 production growth continued with the drilling of 33 gross (17.2 net) and in 2007 was substantially maintained with 21 gross (6.9 net) wells. In the last eight quarters, oil prices have remained robust with sales realized in the range of $62.23/bbl for Q4 2006 to $85.23/bbl in Q4 2007. The 17.8% rise in the Canadian dollar ($0.8662 to $1.0200) reduces the impact of the record setting WTI price. Realized natural gas prices have been quite volatile with a high of $7.82/mcf in Q1 2007 to a new low of $5.33/mcf in Q3 2007. Strong U.S. gas supply and an increase in LNG imports have swelled U.S. gas storage to record levels which put downward pressure on the gas price in 2007. During the last eight quarters, Midnight increased its contribution from oil and NGLs with production rising from 48% to 53% in Q4 2007 and corresponding revenues contributing to over 71% to our petroleum and natural gas sales.

Throughout 2006 and 2007 the cost of oilfield services escalated dramatically in Northern Alberta with the increase in demand for these services resulting in reduced margins for most oil and gas exploration and production companies.

On October 31, 2006, the Federal Government dramatically altered the investment landscape in the oil and gas sector by announcing a number of negative tax initiatives pertaining to income trusts in the resource sector. These initiatives also impacted the valuations of junior oil and gas exploration companies and accordingly negatively impacted their access to capital markets. Furthermore, on October 25, 2007, the Alberta government announced its intent to increase crown royalties through the New Royalty Framework ("NRF") which is scheduled to take effect January 1, 2009. Substantially all of Midnight's production and reserves are in Alberta and will be subject to the NRF. At December 31, 2007, the province had not introduced the enabling legislation nor had they provided clarity on a number of issues. Although the exact details are not yet known, Midnight has undertaken a preliminary review of the potential impact on our existing asset base assessing royalties, the related impact on operating netbacks and the net present value of reserves. Midnight engaged GLJ Petroleum Consultants ("GLJ") to prepare a "look forward" analysis of Midnight's estimated 2007 reserves applying the expected NRF effective January 1, 2009. This preliminary analysis indicated that the net present value of reserves discounted at 10% decreased by approximately 10% to 13% (forecasted prices and costs) from the high to the low scenarios. The estimated negative impact at our light oil property Red Earth was partially offset by deep sweet natural gas production in the Deep Basin and West Central Alberta.

The analysis is based on GLJ's current commodity price forecast effective January 1, 2008 which includes: AECO natural gas price of $6.75 per mmbtu for 2008 and $7.55 per mmbtu for 2009; a WTI crude oil price of US$92.00 per bbl for 2008 and US$88.00 per bbl for 2009 with a forecast exchange rate of $1 Canadian to $1 U.S. The analysis does not take into account future drilling plans that do not have reserves assigned to them at December 31, 2007 and makes certain assumptions regarding future prices and production which could further alter Midnight's estimated net present value if the NRF is enacted into legislation. Overall the NRF will reduce both the value of our existing oil and gas reserves and reduce the future value of our light oil program and becomes a factor in steering our capital program.

Production

During 2007, Midnight maintained strict financial discipline by controlling capital expenditures. As a result, production was relatively flat, averaging 2,098 boe/d for 2007, a 3% decrease from 2006. Production was comprised of 6,050 mcf/d of natural gas, 911 bbl/d of oil and 179 bbl/d of natural gas liquids ("NGLs"). Light sweet oil production increased 29% from 2006 with substantially all of our oil production coming from our core operating area of Red Earth. Yearly average natural gas production decreased 22% from 2006 as a result of limited capital expenditures allocated to gas projects for the year. Q4 2007 production decreased 7% from Q4 2006 with oil production increasing 18% and gas production decreasing 24% with declines and limited capital directed to gas projects.

Our product mix has changed significantly as we continued to focus on our high-value light oil prospects in the Red Earth area in 2007. Oil and NGLs volumes comprised 53% of our production for Q4 2007 compared to 42% for Q4 2006 and YTD 2007 oil and NGLs comprised 52% of our production compared to 40% for the same period in 2006.

Midnight's production forecast for Q4 2007 had incorporated the success of drilling in the east part of Red Earth. Although we have had mixed results from this program, to date we have not added additional production to our base from the fourth quarter drilling. In addition, our high impact Pembina well which was planned for November 2007 has now been delayed due to regulatory matters until late 2008.

The following table outlines our production volumes for the periods indicated below:

Production	**Q4 2007**	Q4 2006	Q3 2007	**2007**	2006
Natural Gas (mcf/d)	**5,573**	7,352	5,981	**6,050**	7,755
Oil (bbls/d)	**820**	694	898	**911**	706
NGLs (bbls/d)	**216**	196	152	**179**	160
Total (boe/d)	**1,965**	2,115	2,047	**2,098**	2,158

Pricing

Midnight's natural gas prices are influenced by overall North American supply and demand balance including imports of liquefied natural gas, seasonal changes, storage levels and transportation capacity. The North American gas market is becoming much more influenced by world gas supply as both LNG supply increases worldwide and U.S. capacity to take LNG increases. Midnight markets its natural gas on a daily spot market basis at various delivery points in Alberta and therefore, the average Alberta spot market price in Canadian dollars per mcf is an appropriate benchmark for our gas prices. During 2007, we received a 6% premium to the Alberta spot price compared to a 1% premium in 2006; we expect to continue to receive a premium to the spot price in 2008 and are forecasting a 3% premium to the posted price.

Midnight's realized oil price has a high correlation to the Edmonton Par benchmark price which generally has a strong correlation to the U.S. benchmark West Texas Intermediate at Cushing, Oklahoma ("WTI") price as adjusted by the Canadian to U.S. dollar exchange rate. Canadian light oil prices correlate to refinery postings that adjust WTI for the Canadian to U.S. dollar exchange rate as well as transportation costs and quality adjustments. Midnight's oil price is significantly influenced by global supply and demand. Although oil prices reached historical highs and the WTI price increased 9% from 2006, the strengthening Canadian dollar reduced the impact for Canadian producers with the Edmonton par price only increasing 5% from 2006. Strong oil prices in 2007 helped increase Midnight's overall realized price. Midnight's oil is light, sweet crude which demands a strong price and has tracked appropriately to the Edmonton par benchmark where we received 97% of the benchmark in 2007 and 96% of the benchmark in 2006. For 2008, we are forecasting a continued strong realized price of 97% of the Edmonton par benchmark.

Prices for Natural Gas Liquids have their own market dynamic. NGLs include condensate, pentane, butane and propane. While prices for condensate and pentane have a relatively strong correlation to oil prices, prices for butane and propane trade at varying discounts due to the market conditions of local supply and demand. During 2007, Midnight's realized NGLs price has been approximately 65% – 70% of the Edmonton par oil price, which is down from 78% in 2006 as lower priced products made up a larger percentage of our NGLs volumes in the year.

Midnight did not buy or sell any commodity or currency hedges during the period and did not have any outstanding at December 31, 2007.

Year-over-year and quarter-over-quarter, Midnight's realized price for commodities has tracked with the appropriate benchmark prices.

The following table outlines benchmark prices compared to Midnight's realized prices:

Prices and Marketing	**Q4 2007**	Q4 2006	Q3 2007	**2007**	2006
Benchmark Prices					
Alberta spot ($/mcf)	**$ 6.01**	$ 6.77	$ 5.07	**$ 6.32**	$ 6.38
WTI oil ($US/bbl)	**90.57**	59.96	75.22	**72.33**	66.09
Cdn/US average exchange rate	**1.020**	0.878	0.956	**0.936**	0.882
Edmonton Par ($/bbl)	**$ 86.89**	$ 64.94	$ 80.67	**$ 77.00**	$ 73.25
Midnight's Realized Price					
Natural gas ($/mcf)	**$ 6.17**	$ 6.84	$ 5.33	**$ 6.68**	$ 6.42
Oil ($/bbl)	**85.23**	62.23	81.23	**74.70**	70.20
NGLs ($/bbl)	**58.26**	44.14	53.13	**52.36**	56.92
Combined oil & NGLs ($/bbl)	**79.62**	58.25	77.16	**71.04**	67.75
Total ($/boe)	**$ 59.81**	$ 48.35	$ 55.43	**$ 56.34**	$ 50.38

Petroleum and Natural Gas Sales

Petroleum and natural gas sales totalled $43.2 million for 2007, up 9% from $39.7 million in 2006. Q4 2007 sales were $10.8 million versus $9.4 million in Q4 2006 and $10.4 million in Q3 2007. The $3.5 million increase in sales from 2006 was due to higher realized prices during the year – sales increased by $4.6 million due to higher realized prices while reduced production volumes accounted for a decrease in sales of $1.1 million. Q4 2007 sales increased 15% from Q4 2006 and 4% from Q3 2007 with a higher realized price accounting for the increase as production in Q4 was down from both of the comparative periods.

The following table outlines our production sales for the periods indicated below:

Petroleum and Natural Gas Sales (000's)	**Q4 2007**	Q4 2006	Q3 2007	**2007**	2006
Natural Gas	**$ 3,165**	$ 4,628	$ 2,933	**$ 14,740**	$ 18,169
Oil	**6,432**	3,975	6,713	**24,852**	18,079
NGLs	**1,156**	795	743	**3,414**	3,324
Royalty income	**58**	12	50	**147**	116
Total	**$ 10,811**	$ 9,410	$ 10,439	**$ 43,153**	$ 39,688

Royalties

Royalty payments are made by producers of oil and gas to the owners of the mineral rights on our leases which include provincial governments (Crown) and freehold landowners as well as to other third parties by way of contractual overriding royalties.

In Alberta, royalties on natural gas and NGLs are charged by the government based on an established monthly Reference Price which is meant to reflect the average price for gas and NGLs in Alberta. The appropriate crown rate is then applied less established deductions to calculate the crown royalties. Gas cost allowance, custom processing credits, and other incentive programs reduce the effective royalty rate.

Oil royalty rates are generally a function of production rates on a per well basis and market prices. Oil royalty rates may also be subject to certain reductions and incentives. Crown royalties in Alberta are generally satisfied by delivering the required amount of oil to the Crown.

For the year 2007, royalties decreased to 15.9% of revenue from 17.8% of revenue for 2006 due to the sharp reduction in natural gas royalties for the year. Natural gas royalties as a percentage of revenue have decreased with increased gas cost allowance ("GCA") in the year from our ownership interest in facilities in Sheldon, Red Earth and West Central Alberta. Gas royalties averaged approximately 22% of gas revenue for 2007 before the impact of GCA. We will continue to receive GCA credits in 2008, but do not expect them to have as large of an impact. We are forecasting gas royalties to average 22% on our base production in 2008 before the impact of GCA credits, but this may increase with new production additions in the Deep Basin. We are forecasting GCA credits to be approximately $250,000 to $300,000 per quarter in 2008. Q4 2007 gas royalty rates were a credit of 1.6% of revenue which is consistent with Q3 2007 credit of 1.0% and a large decrease from the Q4 2006 rate of 15.0% due to the impact of GCA credits.

Oil royalty rates increased to 20% of revenue in 2007 compared to 16% of revenue in 2006. The rates increased as the impact of Third Tier Exploratory Royalty Exemptions decreased in the year and as we brought on wells that were subject to higher royalty rates. We expect our oil royalty rate to continue in the 20% - 25% range for 2008. Q4 2007 oil royalty rates of 21% were consistent with Q3 2007 and increased from 16% in Q4 2006. NGLs royalty rates have remained consistent at approximately 30% of NGL revenues.

For 2007 royalty rates as a percentage of revenue have decreased overall largely due to the impact of GCA credits in the year. Without the impact of GCA and ARTC, our royalty rates would have been similar with the 2007 rate being 21.3% compared to 21.6% in 2006.

The following tables outline our royalties by type and by commodity:

Royalties by Type (000's)	**Q4 2007**	Q4 2006	Q3 2007	**2007**	2006
Crown	**$ 1,403**	$ 1,461	$ 1,425	**$ 6,036**	$ 6,840
Gross overriding	**246**	126	172	**818**	711
ARTC	**-**	(125)	-	**-**	(500)
Total	**$ 1,649**	$ 1,462	$ 1,597	**$ 6,854**	$ 7,051
$/boe	**$ 9.12**	$ 7.51	$ 8.48	**$ 8.95**	$ 8.95
% of revenue	**15.3**	15.5	15.3	**15.9**	17.8

Royalties by Commodity (excluding ARTC)	**Q4 2007**	Q4 2006	Q3 2007	**2007**	2006
Natural Gas					
000's	**$ (50)**	$ 695	$ (27)	**$ 923**	$ 3,711
% of revenue	**(1.6)**	15.0	(1.0)	**6.3**	20.4
Oil					
000's	**$ 1,350**	$ 627	$ 1,407	**$ 4,961**	$ 2,891
% of revenue	**21.0**	15.8	21.0	**20.0**	16.0
NGLs					
000's	**$ 349**	$ 265	$ 217	**$ 970**	$ 949
% of revenue	**30.2**	33.3	29.2	**28.4**	28.5

The current proposed NRF, as previously discussed under the heading titled "Selected Annual and Quarterly Information", will have a negative impact on 2009 royalty rates. Based on the current GLJ price forecast, and the assumptions included in their calculation, our overall corporate royalty rate will increase from 21.2% of revenue to a range of 31.1% to 32.5% of revenue in 2009. This increase includes many assumptions including price forecast, production assumptions and capital deployment decisions which are all subject to change.

Operating and Transportation Expenses

Operating and transportation expenses totalled $9.9 million ($12.91/boe) in 2007 compared to $7.6 million ($9.64/boe) in 2006. The Company classifies transportation expenses with operating costs. Transportation expenses include the cost of delivering production to the custody transfer point including trucking of emulsion from the well site to processing facilities. Operating costs for the year increased over 2006 largely due to the following: strong industry wide demand for materials and services drove increased maintenance charges, higher labour costs, accruals for a new processing fee schedule and processing charges for previously unbilled fees on non-operated properties. The transportation component of operating expenses increased to $956,000 in 2007 from $742,000 in 2006. This increase is due to new production from our Red Earth area where production is trucked to batteries until the well is tied into the existing infrastructure. In Q1 2008, the Company has completed construction of facilities to tie in existing production and to handle additional water that will either be disposed or injected in a waterflood scheme. Once operational, this facility is expected to reduce operating and transportation costs in this area by reducing processing, water disposal, equipment rentals and trucking charges.

Q4 2007 operating and transportation costs increased to $2.9 million from $2.3 million in Q4 2006 and $2.5 million in Q3 2007. The Company has increased its accrual on certain gas processing charges on third party facilities that have not been billed during the year which accounted for part of the increase. Additionally, the Company had a negative adjustment to 2006 operating costs relating to facilities in West Central Alberta. The stand alone operating costs relating solely to Q4 2007 averaged $11.14/boe which provides a reasonable indication of the anticipated operating costs on a go forward basis. With the additional cost savings from our Red Earth water facilities, Midnight expects operating costs to decline below $11/boe.

Operating and Transportation Expenses (000's)	**Q4 2007**	Q4 2006	Q3 2007	**2007**	2006
Operating	**$ 2,746**	$ 2,072	$ 2,227	**$ 8,930**	$ 6,845
Transportation	**200**	216	255	**956**	742
Total	**$ 2,946**	$ 2,288	$ 2,482	**$ 9,886**	$ 7,587
Operating ($/boe)	**$ 15.19**	$ 10.65	$ 11.82	**$ 11.66**	$ 8.69
Transportation ($/boe)	**1.11**	1.11	1.36	**1.25**	0.95
Total ($/boe)	**$ 16.30**	$ 11.76	$ 13.18	**$ 12.91**	$ 9.64

Interest Expense

The 2007 interest expense totalled $1,573,000 with $1,325,000 of the interest incurred on bank debt and $248,000 incurred on charges related to our flow through share obligation. The effective interest rate on our bank debt in 2007 was 5.8%. During 2006, interest expense totalled $1,019,000 representing an effective interest rate of 5.4%. Interest expense increased in the year with the increase in average bank debt and higher interest rates. Our credit facility bears interest at the bank's prime rate or at Bankers' Acceptance rates plus a stamping fee based on the Company's debt to cash flow ratio as defined in the credit facility. The effective interest rate on our bank debt has fluctuated with the changes in the Bank of Canada rates. For 2008 we expect our bank debt to be higher and the effective interest rate is expected to fluctuate with the changes in the Bank of Canada rates and our net debt to cash flow ratio.

General and Administration Expenses

During the year ended 2007, cash general and administration ("G&A") expenses totalled $3.6 million ($4.76/boe) compared to $2.2 million ($2.74/boe) for 2006. In 2006, Midnight's general and administration expenses were

allocated based on an Administrative and Technical Service Agreement ("TSA") with Daylight Energy Ltd. ("Daylight"). Under the agreement, Daylight had been the employer on behalf of the parties and received payment or reimbursement from Midnight for certain technical and administrative services provided to Midnight. The Company was charged for its direct activities and for its proportionate share of overhead based on production and capital spending. With the termination of the TSA on December 31, 2006, Midnight is responsible for its own activities with Daylight still providing certain administrative and other non-competitive services through an agreed upon monthly fee. Thus Midnight expanded in certain technical areas including engineering and operations and as a result direct G&A charges in 2007 increased substantially over 2006. Including the TSA charges for 2006, Midnight's gross G&A increased $1.3 million with increased staffing levels, office premises and other charges necessary to operate as an independent entity. Cash G&A increased with the increase in the gross G&A and lower operating recoveries in 2007.

Q4 2007 cash G&A totalled $1,128,000 an increase of $127,000 over Q3 2007 and $548,000 over Q4 2006. Q4 2007 G&A includes Midnight's matched employee donations of $55,000 to Habitat for Humanity to assist in building affordable housing in our community; Midnight also contributes to this cause by providing manpower on a volunteer basis on certain designated work days. Additional charges in Q4 2007 also included directors' fees and healthcare benefits. As a result of a tight labour market, the costs of retaining employees have risen, we have kept salaries within 2% of the 2006 level and bonuses were limited to 8% corporately. Midnight's Q4 2007 total capitalized G&A and operating recoveries also decreased resulting in a higher cash G&A from Q3 2007.

For 2008, Midnight is projecting gross G&A to total approximately $7 million. The largest portion of our cash G&A is comprised of salaries and benefits and as such, Midnight's cash G&A will depend on the staffing levels in 2008 and any changes to salaries and bonuses.

The components of general and administration expense are as follows:

General and Administration Expenses (000's)	**Q4 2007**	Q4 2006	Q3 2007	**2007**	2006
Direct G&A	**$ 1,796**	$ 896	$ 1,767	**$ 6,414**	$ 1,377
Technical service fee from Daylight	**-**	713	-	**-**	3,749
Overhead recoveries	**(58)**	(238)	(26)	**(181)**	(649)
Capitalized G&A	**(610)**	(791)	(740)	**(2,588)**	(2,317)
Cash G&A	**$ 1,128**	$ 580	$ 1,001	**$ 3,645**	$ 2,160
Stock-based compensation	**153**	101	160	**565**	348
Net G&A	**$ 1,281**	$ 681	$ 1,161	**$ 4,210**	$ 2,508
Cash G&A ($/boe)	**$ 6.24**	$ 2.98	$ 5.32	**$ 4.76**	$ 2.74
Stock-based compensation ($/boe)	**0.85**	0.52	0.85	**0.74**	0.44
Net G&A ($/boe)	**$ 7.09**	$ 3.50	$ 6.17	**$ 5.50**	$ 3.18

Stock-Based Compensation

The Company applies the fair value method for valuing stock option grants and warrants. Under this method, compensation costs attributable to all share options granted and warrants issued are measured at fair value at the grant and issuance date and expensed over the vesting period with a corresponding increase to contributed surplus. The Company capitalizes the related stock-based compensation associated with employee salaries that are capitalized. Midnight recognized stock-based compensation expense of $930,000 for 2007 of which $365,000 was capitalized compared to $765,000 in 2006 with $417,000 capitalized. Stock-based compensation increased in 2007

as 2.2 million options were granted in Q4 2006 and the related expense is recognized for the full year of 2007. During 2007, Midnight granted 309,500 options with a weighted average fair value of $0.69 per option and 954,300 options were forfeited. Midnight's unamortized portion of stock-based compensation is $1.6 million at December 31, 2007.

Depletion, Depreciation and Accretion

For 2007, depletion, depreciation and accretion ("DD&A") was $23.7 million versus $21.7 million for 2006. The increase is a result of higher production and a larger capital base being depleted as well as depleting at a higher rate from higher finding and development costs. On a boe basis, the 2007 charge for DD&A increased to $30.95 from $27.51 in 2006.

For Q4 and Q3 2007, DD&A was $5.9 million while DD&A was $5.7 million for Q4 2006. On a boe basis, Q4 2007 DD&A was $32.64 versus Q3 2007 DD&A charge of $31.13 and Q4 2006 of $29.34.

Taxes

For 2007, a future tax reduction of $1,681,000 (2006 - $60,000) was recognized. During Q4 2007, Federal Bill C-28 was enacted reducing the general federal corporate tax rate to 15% by 2012 from the 2007 rate of 22.12%. The reductions will be phased in from 2008 until 2012 with the combined federal and Alberta provincial tax rate of 25% by 2012. During 2007, Midnight recorded a reduction to its future taxes of $962,000 due to changes in enacted tax rates. The difference in the expected rate of 32.1% and the effective rate for 2007 relates primarily to the future corporate income tax rate reductions and from permanent differences from stock-based compensation.

In Q1 2007, Midnight renounced its flow-through share expenditures and accordingly recorded a $6.2 million future tax liability for the estimated cost of the renounced tax deductions.

Midnight does not expect to become taxable on an income tax basis in 2008 and has approximately $131 million in tax pools to shelter taxable income in the future as detailed below:

Tax Pools (000's)	**2007**
Canadian exploration expense	$ 27,500
Canadian development expense	20,000
Canadian oil and gas property expense	52,300
Undepreciated capital cost	28,600
Share issue costs	2,700
Total	$ 131,100

Funds from Operations and Net Income

For 2007, funds from operations totalled $21.4 million or $0.45 per basic and diluted share. Funds from operations for 2006 totalled $22.0 million or $0.53 per basic and diluted share. For Q4 2007, funds from operations totalled $4.9 million or $0.10 per basic and diluted share. Funds from operations totalled $4.9 million for Q3 2007 and $4.8 million for Q4 2006. The net loss for 2007 totalled $1,219,000 (($0.03) per basic and diluted share) versus net income of $45,000 ($0.00 per basic and diluted share) for 2006. Net loss for Q4 2007 totalled $19,000 versus a loss of $565,000 for the comparative period in 2006.

The following table summarizes the net income on a barrel of oil equivalent basis for the periods indicated.

($/boe)	Q4 2007	Q4 2006	Q3 2007	2007	2006
Sales price	**$ 59.81**	$ 48.35	$ 55.43	**$ 56.34**	$ 50.38
Royalties	**9.12**	7.51	8.48	**8.95**	8.95
Operating expenses	**15.19**	10.65	11.82	**11.66**	8.69
Transportation expenses	**1.11**	1.11	1.36	**1.25**	0.95
Operating netback	**$ 34.39**	$ 29.08	$ 33.77	**$ 34.48**	$ 31.79
General and administration	**6.24**	2.98	5.32	**4.76**	2.74
Interest	**2.04**	1.49	2.33	**2.05**	1.29
Other income	**(0.99)**	-	-	**(0.23)**	(0.16)
Cash flow netback	**$ 27.10**	$ 24.61	$ 26.12	**$ 27.90**	$ 27.92
Depletion, depreciation and accretion	**32.64**	29.34	31.13	**30.95**	27.51
Stock-based compensation	**0.85**	0.52	0.85	**0.74**	0.44
Future tax reduction	**(6.28)**	(2.35)	(1.47)	**(2.19)**	(0.08)
Net income (loss)	**$ (0.11)**	$ (2.90)	$ (4.39)	**$ (1.60)**	$ 0.05

The following table provides reconciliations to the change in funds from operations and net income (loss) for Q4 2007 to Q4 2006 and for the year 2007 to 2006.

Change in Funds from Operations and Net Income (Loss) (000's)	**Q4 2007 to Q4 2006**		**Year 2007 to Year 2006**	
	Funds from Operations	**Net Income (Loss)**	**Funds from Operations**	**Net Income (Loss)**
Comparative period	$ 4,790	$ (565)	$ 21,999	$ 45
Increase (decrease) in revenue:				
Change in production volumes	(670)	(670)	(1,099)	(1,099)
Change in prices	2,071	2,071	4,564	4,564
Change in royalties	(187)	(187)	197	197
Change in other income	179	179	51	51
(Increase) decrease in expenses:				
Operating	(674)	(674)	(2,085)	(2,085)
Transportation	16	16	(214)	(214)
Interest	(79)	(79)	(554)	(554)
Cash general and administration	(548)	(548)	(1,485)	(1,485)
Stock-based compensation	-	(52)	-	(217)
Depletion, depreciation and accretion	-	(189)	-	(2,043)
Taxes	-	679	-	1,621
Current period	**$ 4,898**	**$ (19)**	**$ 21,374**	**$ (1,219)**

Capital Expenditures

During 2007, Midnight's capital program had expenditures of $27.3 million compared to 2006 expenditures of $61.8 million. The Company reduced its capital program to ensure it maintained financial flexibility with limited access to capital markets.

During the year, the Company drilled 21 gross (6.9 net) wells comprised of 17 gross (3.9 net) gas wells, 3 gross (2.5 net) oil wells and 1 (0.5 net) dry holes. This compares to 2006, when the Company drilled 33 gross (17.2 net) wells. Our capital expenditures continued to focus in Red Earth which accounted for 50% of our spending during the year, with 35% spent in the Peace River Arch and 15% spent in West Central. Drilling costs accounted for 49% of our capital spending with completions and facility expenditures accounting for 43%. During Q3 2007, Midnight entered

into a transaction that provided for the sale of certain exploratory lands for $2.0 million and then offset the sale through a participation in the exploration project with a two well commitment retaining a 50% interest in these lands. Geological and geophysical expenditures of $3.4 million include capitalized G&A of $2.6 million.

Midnight has approximately 148,000 net acres of undeveloped land at December 31, 2007. Based on lower cost or market, a value of $19.2 million or $130 per acre for undeveloped land and $4.9 million for undeveloped seismic have been excluded from the depletion calculation in the quarter. In 2008, approximately 40,000 acres of Midnight's net undeveloped acreage will be subject to expiry. The number of acres that actually expire may be reduced through drilling on or adjacent to the expiring lands. We anticipate approximately 18,000 acres will be continued through submission of continuation applications and additional drilling. In Q1 2008, our farm-in activities have added approximately 16,000 acres to our net land position..

In addition to the cash capital expenditures above, we have capitalized $365,000 of stock-based compensation and the related future tax liability of $123,000 for 2007 consistent with the exploration salaries that we have added to our property base.

The following table highlights the breakdown of expenditures by category for the periods indicated:

Capital Expenditures (000's)	**Q4 2007**	Q4 2006	Q3 2007	**2007**	2006
Land	**$ 352**	$ 99	$ 146	**$ 625**	$ 4,997
Geological and geophysical	**629**	3,371	830	**3,379**	6,078
Drilling	**4,299**	1,726	2,404	**13,437**	25,865
Completions	**1,821**	1,619	1,119	**6,154**	10,316
Facilities, pipelines and equipment	**985**	1,837	714	**5,684**	14,477
Other	**6**	-	-	**47**	19
Total expenditures	**$ 8,092**	$ 8,652	$ 5,213	**$ 29,326**	$ 61,752
Land disposition	**-**	-	(1,996)	**(1,996)**	-
Total net expenditures	**$ 8,092**	$ 8,652	$ 3,217	**$ 27,330**	$ 61,752

For the first half of 2008, we have budgeted capital expenditures of $13.5 million. Given the seasonal access of some of our lands and/or timing of certain farm-in opportunities and commitments, we have chosen to aggressively pursue the gas plays in the Deep Basin. We are planning to drill 8 gas targets and 1 oil target in Q1 2008. We will re-evaluate our results for the first quarter and set our budget for the remainder of the year after this time.

Equity

During YTD 2007, Midnight issued 309,500 options to employees and 954,300 options were forfeited during the same period. No options were exercised during 2007. At December 31, 2007 the Company had 2,992,000 options outstanding at an average exercise price of $2.56. Of these, 985,834 have vested and are exercisable at an average price of $2.70. The year end closing price of the Midnight common shares on the TSX was $1.08 per share and no options were in the money.

At December 31, 2007, the Company had 2,013,333 warrants outstanding exercisable into one common share at an exercise price of $3.00 per share. The warrants are fully vested and expire on November 29, 2008.

On October 15, 2007, Midnight filed a notice with the TSX to make a normal course issuer bid to purchase its outstanding common shares on the open market. The TSX has authorized Midnight to purchase up to 4,320,826 common shares representing approximately 9% of its issued and outstanding common shares during the period from October 17, 2007 to October 16, 2008 or until such time that the bid is either completed or terminated at Midnight's

option. Any shares Midnight purchases under this bid will be purchased on the open market through the facilities of the TSX at the prevailing market price. Shares acquired under the bid will be cancelled. During the fourth quarter of 2007, the Company purchased and cancelled 232,700 common shares at an average market price of $1.13 per share reducing the total number of common shares outstanding at year end to 47,595,129. To date in Q1, 2008 the Company purchased and cancelled an additional 172,500 common shares at an average market price of $1.10 per share.

On November 7, 2006, the Company closed a bought deal financing with a syndicate of underwriters and issued 5.5 million common shares at a price of $3.05 per common share to raise gross proceeds of approximately $16.8 million which includes 500,000 common shares issued pursuant to the over-allotment option granted to the underwriters at the same price. Management participated in this issue, acquiring 114,000 shares at $3.05 per share. The offering was done by way of short form prospectus.

On May 17, 2006 Midnight closed a bought deal financing and issued 4 million flow-through common shares at a price of $5.10 per flow-through common share to raise gross proceeds of $20.4 million. Management and service providers participated in this issue acquiring 343,000 shares at $5.10 per flow-through common share. The future tax effect of this issue was recorded in Q1 2007 when the Company renounced the expenditures. The Company incurred all the required qualifying expenditures prior to December 31, 2007.

At March 18, 2008 the Company had outstanding 47,422,629 common shares, 2,994,500 stock options and 2,013,333 warrants. The average exercise price of the stock options outstanding is $2.55 per share.

Share Information (000's)	**Q4 2007**	Q4 2006	Q3 2007	**2007**	2006
Shares outstanding					
Basic	**47,595**	47,828	47,828	**47,595**	47,828
Diluted	**52,600**	53,548	52,953	**52,600**	53,548
Weighted average shares outstanding					
Basic	**47,754**	45,556	47,828	**47,809**	41,640
Diluted	**47,754**	45,556	47,828	**47,809**	41,894

Liquidity and Capital Resources

Midnight Oil Exploration Ltd. is listed as a senior issuer on the Toronto Stock Exchange trading under the symbol "MOX". The Company's market capitalization at December 31, 2007 was $51 million.

Trading History on the TSX	**Q4 2007**	Q4 2006	Q3 2007	**2007**	2006
High	**$ 1.45**	$ 3.38	$ 1.89	**$ 2.39**	$ 4.70
Low	**$ 0.92**	$ 2.26	$ 1.31	**$ 0.92**	$ 2.26
Close	**$ 1.08**	$ 2.37	$ 1.46	**$ 1.08**	$ 2.37
Volume (000's)	**9,987**	4,505	615	**22,336**	13,429

At December 31, 2007, Midnight had drawn $28.9 million on its $37.5 million credit facility and had a working capital surplus of $0.5 million for a net debt position of $28.4 million. On May 31, 2007, Midnight increased its credit facility to $35 million from $30 million. On December 17, 2007, Midnight further increased its credit facility to $37.5 million. Midnight's credit facility is available on a revolving basis until May 31, 2008. On this date and at the Company's discretion, the facility is available on a non-revolving basis for a period of 366 days, at which time the facility would be due and payable. Alternatively, the facility may be extended for a further 364-day period at the request of the

Company and subject to approval by the bank. On this basis, the bank debt is considered Long Term debt for financial reporting purposes. The credit facility bears interest at the bank's prime rate or Bankers' Acceptances plus a stamp based on the Company's net debt/cash flow ratio, calculated using the two most recent fiscal quarters. The credit facility is based solely on the drawn amount and does not have a covenant relating to the company's net debt which includes working capital. The facility is secured by a $50 million first floating charge debenture and a general securities agreement.

Midnight anticipates that it will have adequate liquidity to fund future working capital and forecasted capital expenditures during 2008 through a combination of cash flow and additional drawing on its existing credit facility.

Off Balance Sheet Transactions

There were no off balance sheet transactions entered into during the year, nor are there any outstanding as of the date of this MD&A.

Contractual Obligations

The contractual obligations for which the Company is responsible are as follows:

Contractual Obligations (000's)	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Long-term debt	$ 28,934	$ -	$ 28,934	$ -	$ -
Asset retirement obligations	5,790	241	236	232	5,081
Total Contractual Obligations`	$ 34,724	$ 241	$ 29,170	$ 232	$ 5,081

Midnight enters into many contractual obligations in the course of conducting its day to day business. Material contractual obligations consist of our long-term debt with a major bank and our asset retirement obligation. The payment terms on the asset retirement obligation is based on an estimated timing of expenditures to be made in future periods, actual expenditures and when they may occur may differ materially than presented above. Midnight has not entered into any firm transportation commitments to date.

Relationship with Daylight Energy Ltd. ("Daylight")

Prior to December 31, 2006, Midnight and Daylight Energy Ltd. established and operated under an Administrative and Technical Services Agreement, which provided for the shared services, required to manage the activities of Midnight and Daylight and governed the allocation of general and administrative expenses between the entities. Under this agreement, Daylight Energy was the employer on behalf of the parties and received payment for certain technical and administrative services provided to MOX. The Administrative and Technical Services Agreement was terminated effective December 31, 2006. Certain administrative services which provide reasonable economy and do not involve competitive issues continue to be provided to Midnight by Daylight on a fixed fee basis which has been negotiated by the parties and may be cancelled by either party.

Although the TSA has been terminated, Midnight and Daylight continue to be considered related, as Daylight's Chairman is a director and officer of Midnight. In addition, a director and officer of Daylight is also a director of Midnight. Although this relationship exists, Midnight operates independently from Daylight. Operating, financing and investing decisions are conducted independently without the advice or influence of the other party and each company's strategic direction is set by their respective Boards, both of which have a majority of independent directors. Midnight and Daylight remain joint venture partners in certain properties, and as a result, revenues and costs related to these properties are allocated to each partner under standard joint venture billing arrangements.

Each partner's costs and revenues are based on the exchange amounts which reflect actual third party costs incurred and revenue received. All transactions are conducted under standard business terms and are considered within the normal course of Midnight's business activities and operations. See Note 9 to the Consolidated Financial Statements.

Outlook for 2008

Midnight's 2008 capital program will focus on adding value to its existing reserve base and exploring and developing its prospect inventory. Midnight plans to increase its operated gas program by concentrating our efforts on identified projects in the Deep Basin. This is an area where Midnight has significant experience and expertise and an area where we expect to achieve significant growth. Midnight expects continued volatility in commodity prices throughout 2008. Although we believe that crude oil prices will remain strong, we have a more favourable outlook for natural gas prices in the longer term due to the improving supply/demand fundamentals and the relative valuation of natural gas compared to crude oil.

Towards this, Midnight has entered into a number of arrangements to establish and build a substantial land position in the Deep Basin to explore for its traditional Deep Basin prospects as well as deeper Cadomin resource-type prospects. Early in Q1 2008, Midnight has already entered into two farm-in agreements to earn 100% interest in a large undeveloped land block subject to the payment of non-convertible royalties. Also in Q1 2008, Midnight is participating (50% WI) in a Cadomin horizontal well in Elmworth. We are currently drilling this development well and expect it to be on stream in April 2008.

At Red Earth, Midnight will continue to develop and pursue its light oil prospects. In Q1 2008, the Company drilled a development oil well (25% WI) in central Red Earth. The well encountered the Keg River zone at the structurally highest point in the pool to date and is initially producing over 120 bbls/d at a controlled rate. This well is located within an approved waterflood area and upon approval of Good Production Practise ("GPP") by the ERCB, production will be increased to its capability of over 250 bbls/d. This well opens up a number of additional locations which Midnight, as operator, can pursue later in the year. In Q1 2008, Midnight completed the construction of a water handling and injection facility as part of its waterflood plan for central Red Earth. The facility was commissioned on March 4, 2008 and water is now being injected into this pool. In addition to enhancing recoverable reserves, the facility will reduce operating costs by eliminating the need to truck effluent and pay water disposal fees at non-operated facilities. The wells within the waterflood area also have GPP which allows them to be produced at their capability rather than being allowable restricted. Midnight has a large inventory of oil projects that can be pursued to provide a commodity balance to our gas opportunities.

Early in 2008, the Board of Directors approved a $13.5 million capital program for the first half of 2008. As part of this program, we will drill 10 gross (3 net) wells in Q1 of 2008 and have now completed the construction of our water injection and handling facility at Red Earth. We anticipate having a 2008 capital program of $30 to $35 million which will be financed by funds from operations for the year and our available bank line. This capital program should enable us to double our gas production from approximately 5,100 mcf/d in Q1 2008 to exit 2008 at approximately 10,000 mcf/d and grow our light oil and NGLs from approximately 850 bbls/d in Q1 2008 to exit 2008 at approximately 1,100 bbls/d. The ultimate amount of capital expenditures and production will be dependent on the success of the capital program and the ability to fund additional projects by internally generated cash flows, existing credit facilities and issuing equity should terms be favourable.

Financial Instruments

Financial instruments comprise cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The fair values of these financial instruments approximate their carrying amounts due to their short-term maturities. The Company's long-term debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying value.

Disclosure and Internal Control Procedures

Disclosure and internal control procedures have been designed to ensure that information required to be disclosed by Midnight is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. An evaluation, based on the work of third party specialists who were engaged to formally document internal controls over financial reporting, was carried out. Midnight's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Company's disclosure controls and procedures for the year ended December 31, 2007 are effective to provide reasonable assurance that material information related to Midnight, including its consolidated subsidiaries, is made known to them by others within those entities and the internal controls have been designed over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. It should be noted that while Midnight's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure and internal control procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure and internal control procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

During 2007 and pursuant to the termination of the Administrative and Technical Service Agreement, Midnight has incorporated new internal controls over financial reporting. Effective procedures have been designed and implemented over financial reporting in 2007; however, management is aware that there is a lack of segregation of duties due to the limited number of employees dealing with financial matters. Midnight's Chief Executive Officer, Chief Financial Officer and Vice President Finance have been with the Company since its inception and have extensive industry experience. They are very aware of and actively involved in the Company's on-going operating activities. While there is an inherent weakness in internal controls over financial reporting due to the limited number of staff and the resultant lack of segregation of incompatible duties, the capabilities and involvement of the Chief Executive Officer, Chief Financial Officer and Vice President Finance serve to mitigate this structural weakness. Their efforts, together with the active involvement of the Audit Committee, external auditors and the board of directors, are directed to minimize the risk of a material misstatement in financial reporting.

There were no changes in controls or new weaknesses in controls in Q4 2007.

Application of Critical Accounting Estimates

The significant accounting policies used by Midnight are disclosed in note 1 to the audited Consolidated Financial Statements for the years ended December 31, 2007 and 2006. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management reviews its estimates on a regular basis. The emergence of new information and changed circumstance may result in actual results or changes to estimated

amounts that differ materially from current estimates. The following discussion identifies the critical accounting policies and practices of the Company and helps assess the likelihood of materially different results being reported.

Reserves

Under the National Instrument 51-101 ("NI 51-101") "Proved" reserves are defined as those reserves that can be estimated with a high degree of certainty to be recoverable. The level of certainty should result in at least a 90 percent probability that the quantities actually recovered will equal or exceed the estimated Proved reserves. It does not mean that there is a 90% probability that the Proved reserves will be recovered; it means there must be at least a 90% probability that the given amount or more will be recovered.

"Proved plus Probable" reserves are the most likely case and are based on a 50 percent certainty that they will equal or exceed the reserves estimated.

These oil and gas reserve estimates are made using all available geological and reservoir data, as well as historical production data. All of the Company's reserves were evaluated and reported on by an independent qualified reserves evaluator. However, revisions can occur as a result of various factors including: actual reservoir performance, changes in price and cost forecasts or a change in the Company's plans. Reserve changes will impact the financial results as reserves are used in the calculation of depletion and are used to assess whether asset impairment occurs. Reserve changes also affect other non-GAAP measurements such as finding and development costs, recycle ratios and net asset value calculations.

Depletion and Depreciation

The Company follows the full cost method of accounting for oil and natural gas properties. Under this method, all costs related to the acquisition of, exploration for and development of oil and natural gas reserves are capitalized whether successful or not. Depletion of the capitalized oil and natural gas properties and depreciation of production equipment which includes estimated future development costs less estimated salvage values are calculated using the unit-of-production method, based on production volumes in relation to estimated proven reserves.

An increase in estimated proved reserves would result in a reduction in depletion expense. A decrease in estimated future development costs would also result in a reduction in depletion expense.

Unproved Properties

The cost of acquisition and evaluation of unproved properties are initially excluded from the depletion calculation. An impairment test is performed on these assets to determine whether the carrying value exceeds the fair value. Any excess in carrying value over fair value is an impairment. When proved reserves are assigned or a property is considered to be impaired, the cost of the property or the amount of the impairment will be added to the capitalized costs for the calculation of depletion.

Ceiling Test

The ceiling test is a cost recovery test intended to identify and measure potential impairment of assets. An impairment loss is recorded if the sum of the undiscounted cash flows expected from the production of the proved reserves and the lower of cost and market of unproved properties does not exceed the carrying values of the petroleum and natural gas assets. An impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the lower of cost and market of unproved properties. The cash flows are estimated using the future product prices and costs and are discounted using the risk free rate. By their nature, these estimates are subject to measurement uncertainty and

the impact on the financial statements could be material. Any impairment as a result of this ceiling test will be charged to operations as additional depletion and depreciation expense.

Asset Retirement Obligations

The Company records a liability for the fair value of legal obligations associated with the retirement of petroleum and natural gas assets. The liability is equal to the discounted fair value of the obligation in the period in which the asset is recorded with an equal offset to the carrying amount of the asset. The liability then accretes to its fair value with the passage of time and the accretion is recognized as an expense in the financial statements. The total amount of the asset retirement obligation is an estimate based on the Company's net ownership interest in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. The total amount of the estimated cash flows required to settle the asset retirement obligation, the timing of those cash flows and the discount rate used to calculate the present value of those cash flows are all estimates subject to measurement uncertainty. Any change in these estimates would impact the asset retirement liability and the accretion expense.

Income Taxes

The determination of income and other tax liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. In addition, the Company estimates when its temporary differences are expected to reverse and recognizes its tax assets and liabilities based on the legislated tax rate in those periods. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

Stock-Based Compensation

The Company applies the fair value method for valuing stock option grants and warrants. This method requires the Company to make estimates of expected stock volatility, the expected hold period prior to exercising options, expected forfeitures of options and expected dividends to be declared by the Company. The calculation of the fair value of stock based compensation is not adjusted for the value actual received by the optionees and warrant holders. The stock-based compensation expense will not represent the actual fair value received by the optionees warrant holders as the fair value is estimated at the time of grant and is not adjusted. Due to the time period and the number of estimates involved, it is likely that the actual value of the options and warrants will differ materially from what has been recorded in the financial statements.

Other Estimates

The accrual method of accounting requires management to incorporate certain estimates including estimates of revenues, royalties and operating costs as at a specific reporting date, but for which actual revenues and costs have not yet been received. In addition, estimates are made on capital projects which are in progress or recently completed where actual costs have not been received by the reporting date. The Company obtains the estimates from the individuals with the most knowledge of the activity and from all project documentation received. The estimates are reviewed for reasonableness and compared to past performance to assess the reliability of the estimates. Past estimates are compared to actual results in order to make informed decisions on future estimates.

Financial Reporting Update

Accounting standards adopted

On January 1, 2007, the Company adopted the new Canadian accounting standards for financial instruments – recognition and measurement, financial instruments – presentations and disclosures, hedging and comprehensive income. Adopting these standards had no impact on the measurement of existing financial assets and liabilities.

Recent pronouncements

Effective January 1, 2008, the Company will be required to adopt three new accounting standards: Section 1535, Capital Disclosures, Section 3862, Financial Instruments – Disclosures and Section 3863, Financial Instruments – Presentation. Section 1535, requires disclosure of an entity's objectives, policies and processes for managing capital, including: quantitative data about what the entity considers capital, whether the entity has complied with any capital requirements and the consequences of non-compliance if the entity has not complied. Sections 3862 and 3863 specify standards of presentation and enhanced disclosures on financial instruments. Although the Company is currently assessing the impact of these standards on its financial statements, it is not anticipated that the adoption of these new standards will impact the amounts reported in the Company's financial statements as they primarily related to disclosures.

In February 2008, the Canadian Accounting Standards Board confirmed January 1, 2011 as the effective date for the requirement to report under International Financial Reporting Standards ("IFRS") with the comparative 2010 periods converted as well. The Canadian generally accepted accounting principles (Canadian GAAP) as we currently know them, will cease to exist for all publicly reporting entities. Currently, the application of IFRS to the oil and gas industry in Canada requires considerable clarification. The concept of full cost accounting will not be retained in IFRS. The Canadian Securities Administrators are in the process of examining changes to securities rules as a result of this initiative. Midnight has not yet determined the effect of IFRS on the Company's accounting policies and reporting standards.

Internal Control Reporting

The Canadian Securities Administrators decided not to proceed with the proposed multilateral instrument 52-111 Reporting on Internal Control over Financial Reporting and instead proposed to expand proposed multilateral instrument 52-109 Certificate of Disclosure in Issuers' Annual and Interim Filings. The major changes resulting from this is the CEO and CFO will be required to certify in the annual certificates that they have evaluated the effectiveness of internal controls over financial reporting ("ICOFR") as of the end of the financial year and disclose in the annual MD&A their conclusion about the effectiveness of ICOFR. There will be no requirement to obtain an internal control audit opinion from the issuer's auditors concerning management's assessment of the effectiveness of ICOFR. There is also no requirement to design and evaluate internal controls against a suitable control framework. This proposed amendment is expected to apply for the year ended December 31, 2008. Midnight is continuing with its evaluation of ICOFR to ensure it meets the criteria for the proposed certification deadline.

Risk Factors

There are a number of risk factors facing Companies that participate in the Canadian oil and gas industry. A summary of certain risk factors relating to our business are disclosed below, a more exhaustive list is provided in the Risk Factors Section of our Annual Information Form filed on SEDAR at www.sedar.com.

Exploration, Development and Production Risks

Oil and natural gas exploration involves a high degree of risk, for which even a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that expenditures made on future exploration by Midnight will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over-pressured zones, tools lost in the hole and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

The long-term commercial success of Midnight will depend on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. No assurance can be given that Midnight will be able to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, Midnight may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

In addition, oil and gas operations are subject to the risks of exploration, development and production of oil and natural gas properties, including encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, cratering, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on future results of operations, liquidity and financial condition.

Midnight attempts to minimize exploration, development and production risks by utilizing a high-end technical team with extensive experience and multidisciplinary skill sets to assure the highest probability of success in its drilling efforts. Our collaboration of a team of seasoned veterans in the oil and gas business, each with a unique expertise in the various upstream to downstream technical disciplines of prospect generation to operations, provides the best assurance of competency, risk management and drilling success. A full cycle economic model is utilized to evaluate all hydrocarbon prospects. Detailed geological and geophysical techniques are regularly employed including 3D seismic, petrography, sedimentology, petrophysical log analysis and regional geological evaluation. Midnight utilizes not only the publicly available sources of subsurface data and information, but also employs its own proprietary data set of rock core and drill cuttings descriptions to enhance the quality and probability of success of its internally generated plays and prospects. Where possible prospects have multi-zone potential and activity is focused in regions where Midnight's expertise and experience can provide a competitive advantage.

Prices, Markets and Marketing of Crude Oil and Natural Gas

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of Midnight. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices could result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the volume of Midnight's oil and gas reserves. Midnight might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in Midnight's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to Midnight are expected to be determined in part by the borrowing base of Midnight. A sustained material decline in prices from historical average prices could limit Midnight's borrowing base, therefore reducing the bank credit available to Midnight, and could require that a portion of any existing bank debt of Midnight be repaid.

In addition to establishing markets for its oil and natural gas, Midnight must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas which may be acquired or discovered by Midnight will be affected by numerous factors beyond its control. Midnight will be affected by the differential between the price paid by refiners for light quality oil and the grades of oil produced by Midnight. The ability of Midnight to market its natural gas may depend upon its ability to acquire space on pipelines which deliver natural gas to commercial markets. Midnight will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and many other aspects of the oil and natural gas business.

Midnight has balanced its portfolio between oil and natural gas to help minimize the financial impact of the volatility of the two commodities. The Company's portfolio consists of light quality crude and the majority of its gas is sweet liquids rich natural gas which produces higher netback production helping to mitigate commodity price exposure. Midnight continually monitors the movement of commodity prices, interest rates and capital expenditures and will apply appropriate financial risk management instruments like hedges if it believes these are warranted to maintain a given revenue profile. Midnight has no such instruments in place at this time.

Substantial Capital Requirements; Liquidity

Midnight's cash flow from its reserves may not be sufficient to fund its ongoing activities at all times. From time to time, Midnight may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause Midnight to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. If Midnight's revenues from its reserves decrease as a result of lower oil and natural gas prices or otherwise, it will affect Midnight's ability to expend the necessary capital to replace its reserves or to maintain its production. If Midnight's funds from operations are not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or available on terms acceptable to Midnight.

Midnight's lenders will be provided with security over substantially all of the assets of Midnight. If Midnight becomes unable to pay its debt service charges or otherwise commits an event of default, such as bankruptcy, these lenders may foreclose on or sell Midnight's properties. The proceeds of any such sale would be applied to satisfy amounts owed to Midnight's lenders and other creditors and only the remainder, if any, would be available to Midnight.

Midnight monitors and updates its cash projection models on a regular basis which assists in the timing decision of capital expenditures. Farmouts of projects may be arranged if capital constraints are an issue or if the risk profile dictates that we wish to hold a lesser working interest position. Equity, if available and if on favorable terms, may be utilized to help fund our capital program.

Health, Safety and Environment

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial and local laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and natural gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach of applicable environmental legislation may result in the imposition of fines and penalties, some of which may be material.

Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to governments and third parties and may require the Corporation to incur costs to remedy such discharge.

There are potential risks to the environment inherent in the business activities of the Company. Midnight has developed and implemented policies and procedures to mitigate health, safety and environment (HS&E) risks. These policies and procedures include the corporate HS&E policy, the emergency response plans, the HS&E manual, the pipeline operating and maintenance manual and a process for auditing both safety and environmental compliance. Midnight mitigates HS&E risks by maintaining its facilities and complying with all regulations. Regular field inspections are also carried out to ensure that all field personnel and third party contractors comply with all company and regulatory guidelines. An action plan has been developed to ensure inactive wells are suspended properly and abandoned in a timely fashion. The above noted policies and procedures are designed to protect and maintain the environment and to ensure that the employees, contractors, subcontractors and the public at large are kept safe at all times.

Insurance

Midnight's involvement in the exploration for and development of oil and gas properties may result in Midnight becoming subject to liability for pollution, blow-outs, property damage, personal injury or other hazards. Although Midnight has insurance in accordance with industry standards to address such risks, such insurance has limitations on liability that may not be sufficient to cover the full extent of such liabilities. In addition, such risks may not, in all circumstances be insurable or, in certain circumstances, Midnight may elect not to obtain insurance to deal with specific risks due to the high premiums associated with such insurance or other reasons. The payment of such uninsured liabilities would reduce the funds available to Midnight. The occurrence of a significant event that Midnight is not fully insured against, or the insolvency of the insurer of such event, could have a material adverse effect on Midnight's financial position, results of operations or prospects.

Competition

Midnight actively competes for reserve acquisitions, exploration leases, licenses and concessions and skilled industry personnel with a substantial number of other oil and gas companies, many of which have significantly greater financial and personnel resources than Midnight. Midnight's competitors include major integrated oil and natural gas companies and numerous other independent oil and natural gas companies and individual producers and operators.

Certain of Midnight's customers and potential customers are themselves exploring for oil and natural gas, and the results of such exploration efforts could affect Midnight's ability to sell or supply oil or gas to these customers in the future. Midnight's ability to successfully bid on and acquire additional property rights, to discover reserves, to participate in drilling opportunities and to identify and enter into commercial arrangements with customers will be dependent upon developing and maintaining close working relationships with its future industry partners and joint operators and its ability to select and evaluate suitable properties and to consummate transactions in a highly competitive environment.

Additional Information

Additional information relating to Midnight is filed on SEDAR and can be viewed at www.sedar.com. Information can also be obtained by contacting the Company at Midnight Oil Exploration Ltd., 2100, 144 4th Ave S.W., Calgary, Alberta T2P 3N4 or by email to ir@midnightoil.ca or by accessing our website at www.midnightoil.ca.

CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT'S RESPONSIBILITY STATEMENT

The consolidated financial statements of Midnight Oil Exploration Ltd. and all information in this report are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include amounts that are based on estimates, which have been objectively developed by management using all relevant information. All financial and operating data in this report is consistent with the information in the consolidated financial statements.

Midnight Oil Exploration Ltd. maintains appropriate systems of internal control to give reasonable assurance that transactions are appropriately authorized, assets are safeguarded from loss or misuse and financial records are properly maintained to provide reliable information for the preparation of financial statements. Midnight Oil Exploration Ltd. has effective disclosure controls and procedures to ensure timely and accurate disclosure of material information relating to the Company which complies with the current requirements of Canadian securities legislation.

KPMG LLP, an independent firm of chartered accountants, has been engaged to examine the financial statements and provide their auditor's report. Their report is presented with the consolidated financial statements.

The Board of Directors are responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board of Directors carries out this responsibility principally through its Audit Committee. The Audit Committee is comprised entirely of independent directors and meets regularly with management and with the Company's external auditors to discuss the results of their audit examination and to review issues related thereto. The external auditors have full access to the Audit Committee with and without the presence of management. The Audit Committee reviews the consolidated financial statements and Management's Discussion and Analysis and recommends their approval to the Board of Directors.

Signed *"Fred Woods"*	Signed *"Judy Stripling"*
Fred Woods President and CEO	Judy Stripling Executive Vice President and CFO

Calgary, Alberta
March 18, 2008

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Midnight Oil Exploration Ltd. as at December 31, 2007 and 2006 and the consolidated statements of income (loss), comprehensive income (loss) and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Signed *"KPMG LLP"*
Chartered Accountants

Calgary, Canada
March 18, 2008

Consolidated Balance Sheets
As at December 31,

(000's)

	2007	2006
Assets		
Current assets:		
Accounts receivable	**$ 13,213**	$ 5,928
Deposits and prepaid expenses	**695**	189
	13,908	6,117
Future taxes (note 7)	**-**	391
Petroleum and natural gas assets (note 3)	**150,773**	146,325
	$ 164,681	$ 152,833
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	**$ 13,348**	$ 10,153
Long-term debt (note 4)	**28,934**	17,938
Future taxes (note 7)	**4,273**	-
Asset retirement obligations (note 5)	**2,102**	1,930
Shareholders' equity:		
Share capital (note 6)	**113,032**	119,807
Warrants (note 6)	**40**	42
Contributed surplus (note 6)	**2,442**	1,234
Retained earnings	**510**	1,729
	116,024	122,812
Commitments (note 10)		
	$ 164,681	$ 152,833

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Signed *"Tom Medvedic"*
Director

Signed *"Peter Harrison"*
Director

Consolidated Statements of Income (Loss), Comprehensive Income (Loss) and Retained Earnings

Years ended December 31,

(000's, except per share amounts)

	2007	2006
Revenues:		
Petroleum and natural gas sales	**$ 43,153**	$ 39,688
Royalties	**(6,854)**	(7,051)
Other income	**179**	128
	36,478	32,765
Expenses:		
Operating and transportation	**9,886**	7,587
Interest	**1,573**	1,019
General and administration (note 6 (f))	**4,210**	2,508
Depletion, depreciation and accretion	**23,709**	21,666
	39,378	32,780
Loss before taxes	**(2,900)**	(15)
Future tax reduction (note 7)	**(1,681)**	(60)
Net income (loss) and comprehensive income (loss)	**(1,219)**	45
Retained earnings, beginning of year	**1,729**	1,684
Retained earnings, end of year	**$ 510**	$ 1,729
Income (loss) per share: (note 6)		
Basic	**$ (0.03)**	$ -
Diluted	**$ (0.03)**	$ -

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows
Years Ended December 31,

(000's)

	2007	2006
Cash provided by (used in):		
Operations:		
Net income (loss)	$ (1,219)	$ 45
Items not involving cash:		
Depletion, depreciation and accretion	23,709	21,666
Stock-based compensation	565	348
Future tax reduction	(1,681)	(60)
Abandonment expenditures	(167)	(297)
Changes in non-cash working capital	206	3,558
Cash flow from operations	21,413	25,260
Financing:		
Issue of common shares	-	37,175
Share issue costs	-	(2,369)
Increase in long-term debt	10,996	5,965
Repurchase of common shares	(277)	-
Changes in non-cash working capital	(162)	77
Cash flow from financing	10,557	40,848
Investing:		
Petroleum and natural gas additions	(27,330)	(61,752)
Changes in non-cash working capital	(4,640)	(4,356)
Cash flow from investing	(31,970)	(66,108)
Changes in cash	-	-
Cash, beginning of year	-	-
Cash, end of year	$ -	$ -
Taxes paid	$ -	$ 88
Interest paid	$ 1,380	$ 1,016

Cash is defined as cash and cash equivalents.

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

For the years ended December 31, 2007 and 2006
(Tabular amounts are stated in thousands of dollars except share and per share amounts)

Nature of operations

The principal business of the Company is the exploration for, exploitation, development and production of oil and natural gas reserves. All activity is conducted in Western Canada and comprises a single business segment.

Certain prior period figures have been reclassified to conform with current period presentation.

1. Significant accounting policies

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the reporting period. Actual results could differ from those estimated.

Specifically, the amounts recorded for depletion and depreciation of petroleum and natural gas assets and accretion of asset retirement obligations are based on estimates. The ceiling test is based on estimates of reserves, production rates, oil and gas prices, future costs and other relevant assumptions. The amounts for stock-based compensation are based on estimates of risk-free rates, expected option life and volatility. Future income taxes are based on estimates as to the timing of the reversal of temporary differences and tax rates currently substantively enacted. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(a) Consolidation:

The consolidated financial statements include the accounts of Midnight Oil Exploration Ltd. and its wholly owned subsidiary, Midnight Oil Resources Ltd. and a partnership, Midnight Oil Exploration Partnership. All inter-entity transactions and balances have been eliminated.

(b) Cash and cash equivalents:

Cash and cash equivalents are comprised of cash and all investments with a maturity date of three months or less.

(c) Petroleum and natural gas assets:

(i) Capitalized costs:

The Company follows the full cost method of accounting for petroleum and natural gas assets. Under this method, all costs related to the acquisition of, exploration for and development of petroleum and natural gas reserves are capitalized. These costs include land acquisition costs, geological and geophysical expenditures, rentals and other carrying charges on undeveloped properties, costs of drilling both productive and non-productive wells, oil and gas production equipment and facilities, asset retirement costs and administration expenses directly related to the acquisition, exploration and development activities. Proceeds from the disposition of oil and natural gas properties are accounted for as a reduction of capitalized costs, with no gain or loss recognized, unless such disposition would result in a change greater than 20% in the depletion or depreciation.

(ii) Depletion and depreciation:

Depletion of petroleum and natural gas assets and depreciation of production equipment are calculated using the unit-of-production method, based on production volumes before royalties in relation to estimated proven reserves as determined by an independent petroleum engineering firm. Natural gas reserves and production are converted to equivalent barrels of oil based upon the relative energy content of six thousand cubic feet of gas to one barrel of oil.

The cost of acquisition and evaluation of unproved properties are initially excluded from the depletion calculation. A separate impairment test is performed on these assets to determine whether the carrying value exceeds the fair value. Any excess in carrying value over fair value is an impairment. When proved reserves are assigned or a property is considered to be impaired, the cost of the property or the amount of the impairment will be added to the capitalized costs for the calculation of depletion.

Other assets are depreciated on a declining balance basis at rates ranging from 20% to 35%.

(iii) Ceiling test:

Petroleum and natural gas assets are evaluated in each reporting period to determine that the carrying amount is recoverable and does not exceed the fair value of the properties.

The carrying amounts are assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves, the lower of cost and market of unproved properties and the cost of major development projects exceeds the carrying amount of the cost centre. When the carrying amount is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the cost centre exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves, the lower of cost and market of unproved properties and the cost of major development projects of the cost centre. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

(d) Asset retirement obligations:

The Company recognizes the asset retirement obligations for the future cost associated with removal, site restoration and asset retirement costs. The fair value of the liability for the Company's asset retirement obligation is recorded in the period in which it is incurred, discounted to its present value using the Company's credit adjusted risk-free interest rate and the corresponding amount recognized by increasing the carrying amount of petroleum and natural gas assets. The asset recorded is depleted on a unit of production basis over the life of the reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

(e) Joint interest operations:

Substantially all of the Company's exploration, development and production activities related to oil and gas operations are conducted jointly with others and accordingly the accounts reflect only the Company's proportionate interest in such activities.

(f) Revenue recognition:

Revenue from the sale of petroleum and natural gas is recognized during the month when title passes to a third party.

(g) Income taxes:

The Company uses the asset and liability method of tax allocation accounting. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse.

(h) Flow-through shares:

The resource expenditure deductions for income tax purposes related to exploratory activities funded by flow-through shares are renounced to investors in accordance with tax legislation. Future tax liabilities and share capital are adjusted by the estimated cost of the renounced tax deductions when the expenditures are renounced.

(i) Stock-based compensation plans:

The Company applies the fair value method for valuing stock option grants and warrants. Under this method, compensation cost attributable to all share options granted and warrants issued are measured at fair value at the grant and issuance date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options and warrants, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

(j) Per share information:

Basic per share information is computed by dividing income by the weighted average number of common shares outstanding for the period. The treasury stock method is used to determine the diluted per share amounts, whereby any proceeds from the stock options, warrants or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

(k) Financial instruments:

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument to another entity. Upon initial recognition all financial instruments, including all derivatives, are recognized on the balance sheet at fair value. Subsequent measurement is then based on the financial instruments being classified into one of five categories: held for trading, held to maturity, loans and receivables, available for sale and other liabilities. The Company has designated its cash and cash equivalents as held for trading which are measured at fair value. Accounts receivable are classified as loans and receivables which are measured at amortized cost. Accounts payable and accrued liabilities and long term debt are classified as other liabilities which are measured at amortized cost, which is determined using the effective interest method.

The Company is exposed to market risks resulting from fluctuations in commodity prices, foreign exchange rates and interest rates in the normal course of operations. A variety of derivative instruments may be used by the Company to reduce its exposure to fluctuations in commodity prices, foreign exchange rates, and interest rates. The Company does not use these derivative instruments for trading or speculative purposes. The Company considers all of these transactions to be economic hedges, however, the majority of the Company's contracts do not qualify or have not been designated as hedges for accounting purposes. As a result, all derivative contracts are classified as held for trading and are recorded on the balance sheet at fair value, with changes in the fair value recognized in net income, unless specific hedge criteria are met. The fair values of these derivative instruments are based on an estimate of the amounts that would have been received or paid to settle these instruments prior to maturity given future market prices and other relevant factors. Proceeds and costs realized from holding the derivative contracts are recognized in net income at the time each transaction under a contract is settled.

The Company has elected to account for its physical delivery sales contracts, which were entered into and continue to be held for the purpose of receipt or delivery of non-financial items in accordance with its expected purchase, sale or usage requirements as executory contracts on an accrual basis rather than as non-financial derivatives.

The Company measures and recognizes embedded derivatives separately from the host contracts when the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract, when it meets the definition of a derivative and when the entire contract is not measured at fair value. Embedded derivatives are recorded at fair value.

The Company immediately expenses all transaction costs incurred in relation to the acquisition of a financial asset or liability.

The Company applies trade-date accounting for the recognition of a purchase or sale of cash equivalents and derivative contracts.

2. Changes in accounting policy

On January 1, 2007, the Company adopted the new Canadian accounting standards for financial instruments – recognition and measurement, financial instruments – presentations and disclosures, hedging and comprehensive income. Adopting these standards had no impact on the measurement of existing financial assets and liabilities.

Effective January 1, 2008, the Company will be required to adopt three new accounting standards: Section 1535, Capital Disclosures, Section 3862, Financial Instruments – Disclosures and Section 3863, Financial Instruments – Presentation. Section 1535, requires disclosure of an entity's objectives, policies and processes for managing capital, including: quantitative data about what the entity considers capital, whether the entity has complied with any capital requirements and the consequences of non-compliance if the entity has not complied. Sections 3862 and 3863 specify standards of presentation and enhanced disclosures on financial instruments. Although the Company is currently assessing the impact of these standards on its financial statements, it is not anticipated that the adoption of these new standards will impact the amounts reported in the Company's financial statements as they primarily related to disclosures.

3. Petroleum and natural gas assets

		2007		2006
Cost	$	204,555	$	176,594
Accumulated depletion and depreciation		(53,782)		(30,269)
	$	150,773	$	146,325

During the year ended December 31, 2007, the Company capitalized $2,953,000 (2006 – $2,733,000) of general and administration expenses related to exploration and development activities. Included in this amount is the non–cash related stock-based compensation of $365,000 (2006 - $417,000). In addition, the future tax liability of $123,000 (2006 - $179,000) associated with the capitalized stock-based compensation has been capitalized.

The cost of unproven properties at December 31, 2007 of $24,095,000 (2006 - $27,905,000) has been excluded from the depletion and depreciation calculation. Future development costs of proven reserves of $12,321,000 (2006 - $6,197,000) have been included in the depletion and depreciation calculation.

At December 31, 2007, the Company applied a ceiling test to its petroleum and natural gas assets using expected future market prices of:

Year	WTI Oil ($US/bbl)	AECO Gas (Cdn$/mmbtu)	USD$/CAD$ Exchange Rates
2008	92.00	6.75	1.00
2009	88.00	7.55	1.00
2010	84.00	7.60	1.00
2011	82.00	7.60	1.00
2012	82.00	7.60	1.00
2013	82.00	7.60	1.00
2014	82.00	7.80	1.00
2015	82.00	7.97	1.00
2016	82.02	8.14	1.00
2017	83.66	8.31	1.00
2018	85.33	8.48	1.00
Thereafter	+2.0%	+2.0%	1.00

4. Long-term debt

Midnight has a revolving term credit facility available up to $37.5 million with a Canadian chartered bank. The facility is available on a revolving basis until May 31, 2008. On May 31, 2008, at the Company's discretion, the facility is available on a non-revolving basis for a period of 366 days, at which time the facility would be due and payable. Alternatively, the facility may be extended for a further 364-day period at the request of the Company and subject to approval by the bank. The credit facility bears interest at the bank's prime rate or at Bankers' Acceptance rates plus a stamping fee based on the Company's debt to cash flow ratio, calculated using the two most recent fiscal quarters. The facility is secured by a $50 million first floating charge debenture and a general securities agreement. At December 31, 2007, $28,934,000 (2006 – $17,938,000) was drawn on this facility. The effective interest rate for the bank debt was 5.8% (2006 – 5.4%) for the year ended December 31, 2007. The $37.5 million borrowing base is subject to a semi-annual and annual review by the bank.

5. Asset retirement obligations

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flow required to settle its asset retirement obligations is approximately $5,790,000 (2006 - $5,463,000) which will be incurred from 2008 to 2054. The majority of the costs will be incurred between 2015 and 2030. An inflation factor of 2% has been applied to the estimated asset retirement cost at December 31, 2007 and December 31, 2006. A credit-adjusted risk-free rate of 8% was used to calculate the fair value of the asset retirement obligations at December 31, 2007 and December 31, 2006.

A reconciliation of the asset retirement obligations is provided below:

		2007		**2006**
Balance, beginning of year	$	1,930	$	1,416
Liabilities incurred		143		679
Liabilities settled		(167)		(297)
Accretion expense		196		132
Balance, end of year	$	2,102	$	1,930

6. Share capital

(a) Authorized:

The authorized share capital consists of an unlimited number of common shares without par value.

(b) Issued and outstanding:

	Number of Shares		Amount
Common shares:			
Balance, December 31, 2005	38,327,829	$	84,262
Issued pursuant to private placement	4,000,000		20,400
Issued pursuant to short form prospectus	5,500,000		16,775
Share issue costs (net of tax of $739)	-		(1,630)
Balance, December 31, 2006	47,827,829	$	119,807
Tax effect of flow-through shares issued in 2006			(6,222)
Shares repurchased	(232,700)		(553)
Balance, December 31, 2007	47,595,129	$	113,032

On October 15, 2007, Midnight filed notice with the Toronto Stock Exchange (the "TSX") to make a normal course issuer bid to purchase its outstanding common shares on the open market. The TSX has authorized Midnight to purchase up to 4,320,826 common shares representing approximately 9% of its issued and outstanding common shares during the period from October 17, 2007 to October 16, 2008 or until such time that the bid is either completed or terminated at Midnight's option. Any shares Midnight purchases under this bid will be purchased on the open market through the facilities of the TSX at the prevailing market price. Shares acquired under the bid will be cancelled. During the year ended December 31, 2007 the Company purchased and cancelled 232,700 common shares for total consideration of $277,000. The excess of the average book value over the market price paid is recorded as contributed surplus.

On November 7, 2006 the Company issued 5,500,000 Common Shares at a price of $3.05 per share. The proceeds, net of share issue cost of $1.1 million ($0.7 million net of tax), were $15.7 million.

On May 17, 2006 the Company issued 4,000,000 flow-through Common Shares at a price of $5.10 per share. The proceeds, net of share issue costs of $1.3 million ($0.9 million net of tax), were $19.1 million. Pursuant to the flow-through Common Share offering, the Company renounced $20.4 million of qualifying oil and natural gas expenditures effective December 31, 2006. The future income tax effect and reduction to share capital of $6.2 million was recorded in the first quarter of 2007, the period in which the Company filed the renouncement documents with the tax authorities.

(c) Per share amounts:

The following summarizes the common shares used in calculating per share amounts:

	2007	2006
Weighted average shares outstanding:		
Basic	47,809,160	41,640,158
Diluted	47,809,160	41,893,925

The reconciling items between basic and diluted average common shares outstanding are stock options and warrants. At December 31, 2007 there were 2,992,000 (2006-1,606,800) options that were anti-dilutive and 2,013,333 (2006 – nil) warrants that were anti-dilutive.

(d) Stock options:

The Company has a stock option plan whereby up to 10% of the issued and outstanding common shares may be granted under option to employees, directors and other persons who provide ongoing management or consulting services to the Company. Stock options are granted for a term up to five years and vest over three years from the date granted. The exercise price of each option equals the market price of the Company's common shares on the date of the grant.

The summary of stock option activity is presented below:

	Number of options	Weighted average exercise price
Balance, December 31, 2005	1,099,800	$ 3.50
Granted	2,590,000	2.56
Forfeited	(53,000)	3.49
Balance, December 31, 2006	3,636,800	$ 2.83
Granted	309,500	1.87
Forfeited	(954,300)	3.38
Balance, December 31, 2007	2,992,000	$ 2.56
Exercisable at December 31, 2007	985,834	$ 2.70

The following table summarizes information about the stock options outstanding at December 31, 2007:

	Options Outstanding			Options Exercisable	
Range of exercise price	Number outstanding	Weighted average exercise price	Weighted average remaining contractual life (years)	Number exercisable	Weighted average exercise price
$ 1.00-1.99	234,500	$ 1.81	4.4	–	$ –
$ 2.00-2.99	2,102,500	2.36	3.9	682,500	2.37
$ 3.00-3.99	655,000	3.45	3.0	303,334	3.45
	2,992,000	$ 2.56	3.8	985,834	$ 2.70

(e) Warrants:

	Number of Warrants	Amount
Warrants:		
Balance, December 31, 2005 and 2006	2,083,333	$ 42
Forfeited	(70,000)	(2)
Balance December 31, 2007	2,013,333	$ 40

Each warrant is exercisable into one common share of the Company at a price of $3.00 per share. The warrants vest equally over three years and expire on November 29, 2008. All of the warrants have vested and are exercisable at December 31, 2007.

(f) Stock-based compensation:

Midnight accounts for its stock-based compensation plan using the fair value method. Under this method, a compensation cost is charged over the vesting period for warrants and options granted to employees, officers, directors and other service providers.

Midnight has not incorporated an estimated forfeiture rate for stock options that will not vest, rather the Company accounts for actual forfeitures as they occur.

The fair value of options and warrants granted were estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions and resulting values:

		2007		2006
Fair value of options granted	$	0.69	$	0.95
Risk free interest		4.1%		4.0%
Estimated hold period prior to exercise		4 years		4 years
Expected volatility		40%		40%
Dividend per share	$	0.00	$	0.00

(g) Contributed surplus:

The following table reconciles Midnight's contributed surplus:

		2007		2006
Balance, beginning of year	$	1,234	$	469
Stock-based compensation		930		765
Forfeiture of warrants		2		-
Repurchase of common shares		276		
Balance, end of year	$	2,442	$	1,234

7. Taxes

The provision for taxes in the consolidated statements of income (loss) differs from the result that would have been obtained by applying the combined federal and provincial tax rate to the Company's loss before taxes. The difference results from the following items:

		2007		2006
Loss before taxes	$	(2,900)	$	(15)
Combined federal and provincial tax rate		32.1%		34.5%
Computed "expected" tax recovery	$	(931)	$	(5)
Increase (decrease) in taxes resulting from:				
Non-deductible crown charges		-		765
Resource allowance		-		(889)
Stock-based compensation		181		120
Other		31		(77)
Effect of change in tax rate		(962)		26
Future tax reduction	$	(1,681)	$	(60)

The future tax liability (asset) at December 31 is comprised of the tax effect of temporary differences as follows:

		2007		2006
Petroleum and natural gas assets	$	5,649	$	1,397
Asset retirement obligations		(525)		(560)
Attributed Canadian Royalty Income		(79)		(79)
Share issue costs		(772)		(1,149)
Balance, end of year	$	4,273	$	(391)

8. Risk management

(a) Credit risk:

Portions of the Company's accounts receivable are with joint venture partners in the oil and gas industry and are subject to normal industry credit risks. Purchasers of the Company's oil and natural gas products are subject to an internal credit review designed to mitigate the risk of non-payment.

(b) Commodity price risk:

There were no financial instruments in place to manage commodity prices during the years ended December 31, 2007 and 2006.

(c) Foreign currency:

While substantially all of the Company's sales are denominated in Canadian dollars, the market prices in Canada for oil and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar.

(d) Fair value of financial instruments:

Financial instruments comprise cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The fair values of these financial instruments approximate their carrying amounts due to their short-term maturities. The Company's long-term debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying value.

(e) Interest rate risk:

The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact the Company's cash and cash equivalents that have a floating interest rate. The bank facility is also based on a floating interest rate. The Company had no interest rate swaps or hedges at December 31, 2007.

9. Related Party

Prior to December 31, 2006, Midnight and Daylight Energy Ltd. ("Daylight") established and operated under an Administrative and Technical Services Agreement, which provided for the shared services, required to manage the activities of Midnight and Daylight and governed the allocation of general and administrative expenses between the entities. Under this agreement, Daylight Energy was the employer on behalf of the parties and received payment for certain technical and administrative services provided to MOX. The Administrative and Technical Services Agreement was terminated effective December 31, 2006. Certain administrative services which provide reasonable economy and do not involve competitive issues continue to be provided to Midnight by Daylight on a fixed fee basis which has been negotiated by the parties and may be cancelled by either party.

Although the Administrative and Technical Services Agreement has been terminated, Daylight and Midnight continue to be considered related, as a director and officer of Midnight is Daylight's Chairman. In addition, a director and officer of Daylight is also a director of Midnight. Midnight and Daylight are joint venture partners in certain properties, and as a result, revenues and costs related to these properties are allocated to each partner under standard joint venture billing arrangements. Each partner's costs and revenues are based on the exchange amounts which reflect actual third party costs incurred and revenue received. All transactions are conducted under standard business terms and are considered within the normal course of Daylight's business activities and operations.

Pursuant to the Administrative and Technical Services Agreement, Daylight charged Midnight $3.7 million for the year ended December 31, 2006 and Midnight had a payable balance of approximately $2.1 million due to Daylight at December 31, 2006. For the year ended December 31, 2007, Daylight charged Midnight $1.4 million for administrative

services and premises costs. At December 31, 2007 Midnight had a receivable balance, which includes joint venture and commodity marketing amounts of approximately $4.7 million due from Daylight.

10. Commitments

The Company renounced $20.4 million of qualifying oil and natural gas expenditures effective December 31, 2006 pursuant to the flow-through share offering which closed on May 17, 2006. As at December 31, 2007 the Company had incurred all (2006 – $10.3 million) of the required qualifying expenditures.

Selected Quarterly Information

	2007				2006			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Financial (000's, except for per share amounts)								
Petroleum and natural gas sales	$ 10,811	$ 10,439	$ 11,009	$ 10,894	$ 9,410	$ 10,099	$ 10,988	$ 9,191
Royalties	1,649	1,597	1,618	1,990	1,462	1,966	1,969	1,654
Operating expenses	2,746	2,227	1,781	2,176	2,072	1,518	1,610	1,645
Transportation expenses	200	255	312	189	216	167	168	191
Netback	$ 6,216	$ 6,360	$ 7,298	$ 6,539	$ 5,660	$ 6,448	$ 7,241	$ 5,701
G&A – cash charge	1,128	1,001	803	713	580	645	499	436
Interest	369	439	426	339	290	324	235	170
Other income	(179)	-	-	-	-	-	(9)	(119)
Capital tax	-	-	-	-	-	-	(17)	17
Funds from operations	$ 4,898	$ 4,920	$ 6,069	$ 5,487	$ 4,790	$ 5,479	$ 6,533	$ 5,197
Per share – Basic	0.10	0.10	0.13	0.11	0.11	0.13	0.16	0.14
– Diluted	0.10	0.10	0.13	0.11	0.11	0.13	0.16	0.13
Net income (loss)	$ (19)	$ (827)	$ 51	$ (424)	$ (565)	$ 320	$ 82	$ 208
Per share – Basic	(0.00)	(0.02)	0.00	(0.01)	(0.01)	0.01	0.00	0.01
– Diluted	(0.00)	(0.02)	0.00	(0.01)	(0.01)	0.01	0.00	0.01
Petroleum and natural gas additions	$ 8,092	$ 3,217	$ 3,439	$ 12,582	$ 8,652	$ 13,670	$ 9,945	$ 29,485
Net debt	28,374	24,886	26,577	29,170	21,974	33,579	25,297	41,028
Total assets	164,681	160,573	161,537	159,594	152,833	147,677	138,842	134,452
Shares outstanding Basic	47,595	47,828	47,828	47,828	47,828	42,328	42,328	38,328
Diluted	52,600	52,953	53,168	53,001	53,548	45,914	45,903	41,495
Operations								
Average daily production								
Natural gas (mcf/d)	5,573	5,981	5,769	6,891	7,352	7,637	10,091	5,926
Oil & NGLs (bbls/d)	1,036	1,050	1,185	1,090	890	841	830	901
Combined (boe/d)	1,965	2,047	2,146	2,239	2,115	2,114	2,512	1,889
Average prices received								
Natural gas ($/mcf)	$ 6.17	$ 5.33	$ 7.22	$ 7.82	$ 6.84	$ 5.85	$ 5.98	$ 7.39
Oil & NGLs ($/bbl)	79.62	77.16	66.76	61.39	58.25	77.01	72.38	64.17
Combined ($/boe)	$ 59.81	$ 55.43	$ 56.37	$ 54.06	$ 48.35	$ 51.92	$ 48.07	$ 54.07
Royalties	9.12	8.48	8.29	9.88	7.51	10.11	8.61	9.73
Operating expenses	15.19	11.82	9.12	10.80	10.65	7.80	7.04	9.68
Transportation expenses	1.11	1.36	1.59	0.93	1.11	0.86	0.74	1.12
Netback received ($/boe)	$ 34.39	$ 33.77	$ 37.37	$ 32.45	$ 29.08	$ 33.15	$ 31.68	$ 33.54

CORPORATE INFORMATION

DIRECTORS

FREDERICK N. WOODS
President and Chief Executive Officer
Midnight Oil Exploration Ltd.
Calgary, Alberta

PETER T. HARRISON [1, 2, 3, 4]
Senior Vice-President
Montrusco Bolton Investment Inc.
Brossard, Québec

ANTHONY M. LAMBERT [2, 3, 4]
President and Chief Executive Officer
Daylight Resources Trust
Calgary, Alberta

TOM J. MEDVEDIC [1, 2, 3, 4]
Senior Vice-President, Finance and
Chief Financial Officer
Calfrac Well Services Ltd.
Calgary, Alberta

JAY D. SQUIERS [1, 2, 3, 4]
Principal
American Capital Energy Group
Dallas, Texas USA

Members of the following Committees
1 Audit
2 Compensation
3 Reserves
4 Corporate Governance

MIDNIGHT
Oil Exploration Ltd.

CORPORATE OFFICE

Sun Life Plaza, West Tower
Suite 2100, 144 – 4th Avenue S.W.
Calgary, Alberta T2P 3N4
Phone: 403-303-8500
Fax: 403-264-0085
Email: ir@midnightoil.ca
Website: www.midnightoil.ca

BANKER

Canadian Imperial Bank of Commerce
Calgary, Alberta

LEGAL COUNSEL

Burnet, Duckworth & Palmer LLP
Calgary, Alberta

AUDITORS

KPMG LLP
Chartered Accountants
Calgary, Alberta

EVALUATION ENGINEERS

GLJ Petroleum Consultants
Calgary, Alberta

REGISTRAR AND TRANSFER AGENT

Valiant Trust Company
Calgary, Alberta

TSX SYMBOL: MOX

OFFICERS

FREDERICK N. WOODS
President and Chief Executive Officer

JUDITH A. STRIPLING
Executive Vice-President and Chief Financial Officer

THOMAS F. MOSLOW
Senior Vice-President, Exploration

ANDREW D. WELDON
Vice-President, Business Development

CHAD L. KALMAKOFF
Vice-President, Finance

C. DONALD LEITCH
Vice-President, Operations

PETER R. O'LEARY
Vice-President, Geology

E. MARTIN SAIZEW
Vice-President, Engineering

CHRIS VON VEGESACK
Corporate Secretary
Partner
Burnet, Duckworth & Palmer LLP
Calgary, Alberta

MIDNIGHT
Oil Exploration Ltd.

Sun Life Plaza, West Tower
Suite 2100, 144 – 4th Avenue S.W.
Calgary, Alberta T2P 3N4
Phone: 403-303-8500
Fax: 403-264-0085
Email: ir@midnightoil.ca

www.midnightoil.ca